ATT Welcome, March 2016

Welcomes

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In pensions we trust

I hope George Osborne doesn't change the pensions tax rules in his Budget speech. There are many rumours in the press suggesting that tax reliefs will be reduced but I feel any change would have a negative impact on a fragile pensions industry.

The demographic time bomb, first predicted back in the 1980s, is now on our doorstep and it's important that the public have as much confidence as possible in the pensions industry so that they will be encouraged to save for their future and avoid the financial burden being placed on our children.

I have found that the public's confidence in pensions has increased since the introduction of the freedoms and flexibility set out in the Taxation of Pensions Act 2014, so fingers crossed this confidence will continue after the Budget.

In November, the Finance (No 2) Act 2015 received royal assent and clarified the taxation of money purchase pensions (defined contribution pensions) left to a trust when the stakeholder dies.

For most money purchase pensions it is now possible to have a choice on death: to leave the pension to a trust, pay out directly to your beneficiaries, or to cascade the pension down to family or friends, free of inheritance tax, within the framework of the pension scheme wrapper, known as Flexi Access.

For most money purchase pensions, if the stakeholder dies before they turn 75 the payment to a trust is tax-free. This provides the opportunity for succession planning and controlling the value of the assets after death. The other choices are that the fund can be paid directly to the deceased's beneficiaries tax-free, or cascaded down to children, grandchildren, widow or friends free of inheritance tax in most situations. The recipients of a flexi-access pension, known as nominees, can

continue drawing tax-free income and capital out of a tax-privileged regime, where all growth and most of the income generated from investments is also tax-free within the wrapper for the rest of their lives.

Developing a strategy becomes more complicated if a client dies after the age of 75, but at least Finance (No 2) Act 2015 gives us clarity. I still believe that, for clients who want to leave their pension funds on death to a spouse, children, grandchildren or friends, a combination of bequeathing the death benefits to a discretionary trust plus using flexi-access rules to nominate a range of beneficiaries within the pension scheme is the best pre-death strategy. However, it is essential to document clearly what the client's wishes are in a formal letter of wishes.

The payment to a trust if the client dies after they have turned 75 is taxed at 45%. But there is an income tax credit for the beneficiary, so it may not be as bleak as this may initially sound. For example:

- Clive dies aged 79. The value of his money purchase pension is £300,000. The pension administrator pays a lump sum to a trust and pays a tax bill of £135,000 (45% of £300,000), leaving £165,000 to be held by the trustees.
- In the next year, with the fund still worth £165,000, the trustees decide to distribute £20,000 to Clive's son, Chris.

Chris will be treated for tax purposes as receiving £36,363 (£36,363 x 45% = £16,363; £36,363 - £16,363 would leave a net sum of £20,000). Chris will be assessed on £36,363 as income in the year of receipt. However, Chris is a basic rate tax payer and his liability on £36,363 would be £7,272. Since he has a tax credit of £16,363, representing the attributed portion of the 45% paid by the pension administrator on the initial payment to the trust, not only can he offset this credit against the liability of £7,272 (so he pays no tax on the £20,000 he has received) but he can also receive a further tax credit of £9,090 to set against other income.

If the benefits are not paid to a trust if death is after age 75, the taxation is straightforward in that the beneficiaries are taxed at their marginal rate on receipt of them.

The alternative, if the appropriate paperwork is in place before death, is that the pension fund can be passed down to children or grandchildren without a tax charge. But when the beneficiaries take funds from their new flexi-access pension, the withdrawals will be taxed on them as income.

The importance of a client planning a strategy during their lifetime, with their advisers’ help around the new rules, is fundamental to realising the best outcome for their client and their family.