Chartered Financial Planners

BreedElliott

happiness through sensitive financial planning

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Understanding Modern Pension Plans – Part III

This is the third and final newsletter in our series looking at the features and potential benefits of modern pension plans.

When we say 'modern' pension plans, we are concentrating on defined contribution pension arrangements, where your contributions accumulate a pot of money which you can use in retirement in a fairly flexible manner as a result of the 'freedom and choice' changes in pension legislation introduced in April 2015.

In the last two newsletters, we have focused firstly on those investors who are accumulating pension funds in modern pension contracts. We have then looked at those who have successfully accumulated sizeable pension pots and are now considering their many options on how best to take benefits from those funds.

In this newsletter, we will turn to those in later life who have kept their pension funds in flexible, modern arrangements and are now contemplating what could happen with any pension funds remaining when they die.

The importance of age 75

With old-style pension plans, age 75 was an important milestone as benefits had to be taken from the pension plan when the planholder reached that age. Now, there is nothing in tax legislation requiring benefits to come into payment when the planholder reaches age 75.

However, age 75 remains a milestone in three ways. Firstly, it is the final point when pension funds are assessed against the Lifetime Allowance, which could lead to additional tax charges. Secondly, no further tax-relievable contributions can be made after age 75.

Thirdly, if the planholder dies before attaining age 75, the value of their accumulated pension funds can be passed on tax-free, whereas after age 75 the pot is taxed at the marginal rate of the recipient. This third consideration is not a very easy thing to plan for and if undertaken, can be very complex!

Even so, it is worth monitoring the situation carefully as we approach our 75th birthdays.

Crystallisation

The term 'uncrystallised' refers to pension funds from which benefits have yet to be taken. Crystallising a pension fund means that the decision has been taken to start withdrawing benefits in the form of a tax-free cash sum and/or a taxable pension income.

Both crystallised and uncrystallised funds can be kept beyond the age of 75 up until death, with the only difference being that 25% of uncrystallised funds can still be withdrawn as a tax-free cash sum.

What happens to crystallised and uncrystallised funds on death?

Both crystallised and uncrystallised funds are treated in the same way and there are a number of options as to how the fund can be paid out. However, a key thing to bear in mind for planholders aged over 75 with uncrystallised funds is that they may wish to crystallise the fund sooner rather than later. Because the fund is uncrystallised, the planholder could access 25% of the fund tax-free during their lifetime. If they do not take the tax-free cash, that 25% of the fund may be subject to tax on death.

However, at the same time, taking this tax-free cash may increase their liability to Inheritance Tax. Each scenario needs to be considered on its individual merits.

The beneficiaries of a pension fund can choose to take the pension in the following ways:

1. They could withdraw all of the money as a lump sum. If the pension planholder had died before age 75, the lump sum would be paid tax-free. If they died after age 75, the beneficiary would have to pay tax on the lump sum at their highest marginal rate.

2. They could use the remaining fund to purchase a guaranteed pension income using an annuity. The income generated would be tax free if the planholder died before they reached their 75th birthday and taxed at the beneficiary's highest marginal rate if the planholder died after attaining age 75.

3. They could effectively take over the pension plan, although this may involve transferring the funds to a new policy or account. Any income subsequently drawn from the pension plan would be tax free if the planholder died before age 75 and taxed at the beneficiary's highest marginal rate if the planholder died after age 75.

What about Inheritance Tax (IHT)?

Any assets left when you die such as cash or savings (even if they were originally part of your pension pot), such as your tax-free cash, will form part of your estate for IHT purposes.

In most cases, a crystallised or uncrystallised pension fund can be passed outside of the estate and will not be subject to IHT. However, for this to be the case, the administrator of the pension plan would need to have discretion as to who the benefits are paid to.

Generally, most pensions are set up under a discretionary trust. Where this is the case, it means the trustees have the right to choose who ultimately receives anything that is payable from the pension fund on death. Where this is the case, it usually means that the value will not be counted as part of the estate and so will not be subject to IHT.

We encourage clients to submit a nomination form, often referred to as an ‘expression of wish form’ which allows the planholder to tell the pension scheme administrator who they would like to benefit from the funds in the event of death. The scheme administrator does not have to follow these wishes, though generally they will.

Pension funds ‘cascading down the generations’

What happens when a beneficiary of a pension fund chooses option 3 above and then subsequently dies?

By choosing option 3, they are effectively taking over the running of the pension fund, which means that they can now nominate their own beneficiaries.

So, for example, a grandparent may die with unused pension funds, naming their child as the beneficiary. The child chooses to keep the funds in a modern pension contract in their own name and nominate their child, the grandchild, as their beneficiary. The funds can then be passed to the grandchild should there be any left when the child dies.

In this way, we can see pension funds cascading down the generations.

How can I tell whether my pension is a modern pension contract?

If it is important to you to have all of these options available, it is essential that you have a modern pension contract which allows for all of the freedom and choice available through legislation. Important decisions may need to be made prior to reaching age 75 and prior to death.

It is important to check with your pension provider to ensure that your current pension plan provides you with the necessary flexibility.

Clearly, we are experienced in checking this for many clients and we are very willing to help as needed.

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Market data

Market	Value at start of 2020	Current situation	Comments
Interest Rates (BOE base rate)	0.75%	0.1% at 31/07/21	The official bank rate is 0.1%.
House Prices (Nationwide)	House prices increased by 7.3% in 2020	House prices down by 0.5% at 31/07/21	Annual house price growth up 10.5%.
UK Share Prices (FTSE 100)	7542.40	7035.41 at the close on 31/07/21	The FTSE 100 fell by 17.21 points in July.

Helping you to manage your money

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