

Nominating pension benefits

Before 6 April 2015, a 55% tax charge was levied on the pension fund of any investor who died while drawing income from their fund under a drawdown contract.

Now, such lump sum payments on death are tax-free if the death occurs before age 75. If later, the beneficiaries will be subject to tax at 45% if the death occurs in the tax year 2015/16 and at their marginal tax rate thereafter.

Those inheriting pension benefits on the death of the investor are in the same position, tax-wise, as the investors themselves. So on deaths before age 75 the benefits can be passed on with no tax charge, from one generation to the next.

The freedom from 'death tax' of pension benefits passing after 6 April 2015 is subject to the condition that the beneficiary must either move into 'flexi-access' drawdown or take a lump sum payment within two years of the death.

If the intentions of investors and those who inherit pension benefits are to be realised, it is vitally important that they should make clear to the trustees of the pension fund whom they wish to benefit. This is done by filing a 'nomination' form with the trustees, which should ideally be accompanied by a 'letter of wishes', containing more detailed information such as the effect of any changes in circumstances.

However, births, deaths, marriages and divorces cannot be anticipated and may well affect the choice of beneficiaries. Consequently, nominations and letters of wishes should be reviewed and up-dated regularly.

These two forms of instruction to trustees are not, however, binding, and trustees have an ultimate discretion. If they were binding, they might override the provisions of a Will and result in a tax charge on the beneficiaries.

By-passing the spouse

Before the 'pension freedoms' were introduced, it was common practice for pension holders with reasonably substantial pension pots to divert their pension rights away from their surviving spouse if that person had no need of the money and it would be more tax-efficient to pass it directly to children or other dependents. This was done by setting up a 'spousal by-pass trust'.

The fact that pension assets can now be passed between generations free of inheritance tax has caused many people to assume that such trusts will no longer be required. However, they do have their uses, which arise out of the discretion enjoyed by the trustees when distributing benefits.

For example, in the case of second marriages, the interests of children of the first marriage could be protected. Equally, benefits could be withheld from bankrupts or those going through a divorce or in circumstances where means-tested benefits might be affected.

The trust will be effective to divert funds away from the surviving spouse, but it is the nomination and letter of wishes which influence the selection of beneficiaries.

Reducing pension allowance

One of the issues confronting the Government as a result of the new pension freedoms is that people might be tempted to use the income they receive from their pension to make additional contributions, on which they would receive tax relief for a second time.

The annual allowance for pension contributions currently stands at £40,000 p.a., but in order to limit people's ability to 'recycle' pension income, the Government has decreed that in circumstances where any income is drawn from a pension fund under the new 'flexi-access' provisions, the allowance will reduce to £10,000. This is

referred to as the Money Purchase Annual Allowance ('MPAA').

MPAA will not affect 'capped drawdown' arrangements, under which the income which can be drawn is restricted by the Government with a view to ensuring that investors do not exhaust their pension pots prematurely.

Also unaffected by MPAA are the investment of tax-free cash from a fund and the application of drawdown funds to purchase an annuity.

Due diligence

The Solicitors Regulation Authority requires that when solicitors refer clients to a financial adviser, the clients must be in a position to make an informed decision that the referral will be in their best interests.

This means that solicitors must themselves be in a position to make this judgment and will need to obtain 'due diligence' information on the adviser involved, which they can compare with information on possible alternative advisers.

The 'due diligence' statements are likely to highlight the independence, qualifications and relevant experience of the advisers and be in a form which solicitors can share with their clients.

If you would like to discuss any of these matters further please contact us

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