



## STIRLING HOUSE A-DAY PREPARATION

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**From 6<sup>th</sup> April 2006, new rules will apply to the amount of lump sum death benefits and dependants' pensions that can be provided from your pension arrangements.**

### **Death Benefits: Key Facts**

- If you die before retirement, your pension fund can normally be paid as a lump sum. The lump sum will be tax-free if your fund value is no higher than your available Lifetime Allowance at the date of your death. If your fund value is more than your available Lifetime Allowance, the excess can still be paid as a lump sum, but will be taxed at 55%. (See Lifetime Allowance Section).
- If you die before retirement Dependants' pensions can also be provided in addition to any lump sum death benefit. No restrictions will apply to the amount of dependants pension payable, although the pensions will be taxable. Dependants' pensions will not count towards the Lifetime Allowance of the dependant receiving the pension or the individual whose funds have been used to buy the pension.
- If you die after retirement, the death benefits payable will depend on the type of retirement benefit you were receiving at the time of your death. (See Retirement Options Section).
- Dependants' pensions will normally be unrestricted, although if a scheme pension has been chosen, on death after age 75, the total of any dependants pensions will be limited to an amount not greater than the annual amount of the pension you were receiving, immediately prior to your death.
- If you were taking an Unsecured Pension at the time of your death, any lump sum payment will be subject to a 35% tax charge. Your dependants can also choose to continue with an Unsecured Pension until they reach age 75, or choose an Alternatively Secured Pension if over 75, Or they can buy a 'Secured Pension' (annuity). These pensions and/or annuities will be taxable at the recipient's marginal rate of tax. If a dependant dies whilst in receipt of Unsecured Pension, the residual fund can be paid out subject to a 35% tax charge. No lump sum death benefit can be paid if the dependant is in receipt of an Alternatively Secured Pension, or a Secured Pension at the time of their death.
- Special rules apply to the death benefits payable from Alternatively Secured Pensions in payment. See the example below.
- If you were taking a Secured Pension at the time you die, and your death fell within a guaranteed period (which can be up to a maximum of 10 years from when your pension first started), any outstanding guaranteed instalments will continue to be paid to your estate. These instalments cannot be commuted for a lump sum. You can also choose a dependant's pension to be paid on your death or at the end of any guaranteed period if later, in return for a smaller starting pension. Value protected annuities will permit a lump sum to be paid from a secured pension in payment, the value of which cannot exceed the purchase price of the annuity, less the value of any instalments paid. Such lump sums can only be paid on death before age 75, and will be subject to a 35% tax charge.
- A new definition of 'dependant' will be introduced, and includes a spouse, an ex-spouse (if married to the individual at the date the pension was first paid), a child under 23, a child who is financially dependent because of physical or mental impairment, and anyone else who is financially dependent. If a pension is being paid to a dependant child at A-Day, then this may continue in payment until the later of the child reaching age 23, or ceasing full time education or vocational training.
- No lump sum death benefits can be paid if you die after age 75; regardless of how you choose to take your pension benefits.
- Importantly, if you are a member of a Final Salary (Defined Benefit) scheme then the death benefits will be governed by the rules of that scheme.



## Death Benefits: Questions & Answers

**Q: If I die after age 75 whilst taking an alternatively Secured Pension, what happens to my remaining fund?**

**A:** The value of your fund must be used to provide a dependant's pension which could be a Secured Pension, an Unsecured Pension or, if they are aged over 75, an Alternatively Secured Pension. If you have no dependants, a lump sum, can be paid to a charity (if you previously nominated one) or transferred to another member of the same scheme to be held to provide pension benefits.

**Q: My employers occupational pension scheme provides me with a lump sum of four times my salary if I die in service. Will these new rules mean I will receive more if I die in service?**

**A:** The answer depends on how, if at all, the scheme trustees amend the scheme rules. The trustees may decide to retain the existing limits on lump sum death benefits. Remember that a Lifetime Allowance charge could also be imposed if you have other pension death benefits of significant value, or have a particularly high pensionable salary. If you have any concerns, you should speak to your scheme trustees in the first instance.

### DEATH BENEFITS: CASE STUDY

Donald is aged 60 and in poor health. He has a personal pension fund of £500,000 and other income of £10,000 p.a. from his investment portfolio. He nominated his wife Elizabeth and his two children as beneficiaries when he first set up his pension plan. He retired last year and, although he doesn't need additional income, he wants to ensure Elizabeth, aged 59, has security should he die within the next few years. He wants to know which retirement option will provide Elizabeth with the security she needs.

Donald has a number of options – here are a few:

- a) Leave his fund as is. If he dies, the trustees will pay the fund as a tax-free lump sum to his nominated beneficiaries.
- b) Buy a 'Secured Pension' (annuity) with 100% spouse's pension. If Donald dies before Elizabeth, she would have a secure income for life. Her income will be taxable.
- c) Buy an 'Unsecured Pension'. Here, Donald can draw down income from his fund. He can take a 25% tax-free lump sum and no income if he wants. If he dies before age 75, the residual fund can be paid as a lump sum less 35% tax, or Elizabeth can continue taking an Unsecured Pension until age 75, and then buy a Secured Pension (annuity) or an Alternatively Secured Pension.

The decision Donald makes is very important for Elizabeth's future well being and likely to be one of the biggest financial decisions during his lifetime. It is therefore very important that Donald seeks financial advice before making that decision.

### Important Information

Please note that the information provided in this document is based on Stirling House Financial Services' understanding of existing and proposed legislation and HMRC practice, all of which may be subject to change in the future. The information is based on the assumption that tax legislation is not changed.