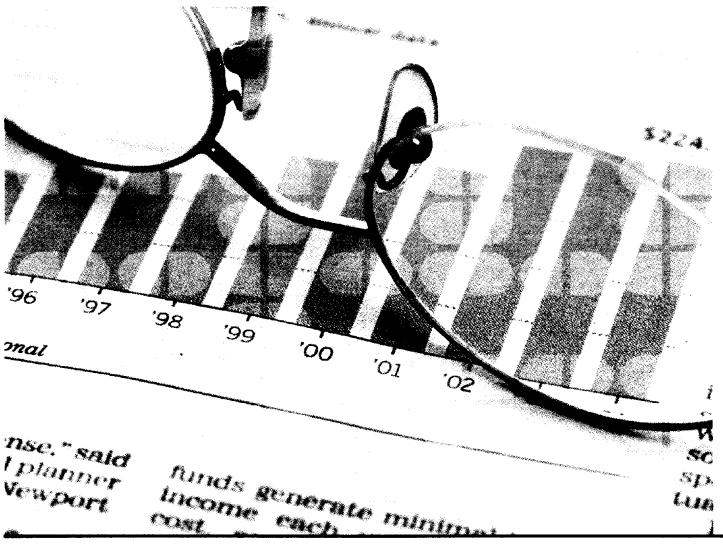

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Abolition of pension 55% death tax

Following the announcement of new pension flexibility from April 2015, the Chancellor has stated plans to significantly change the taxation of pension funds on death. Most notably, this will see the abolition of the 55% death charge on the pension funds of those people in "drawdown" who die before reaching age 75.

A summary of the tax changes as announced follows, but these may still be subject to change when actual details are published (probably with the Autumn Statement in December 2014).

Current rules

Currently, the taxation of a pension fund depends on the individual's age at death and whether retirement benefits have already been taken.

If the individual is under age 75 and the pension fund is as yet untouched, the fund can be paid as a tax-free lump sum.

Where retirement benefits have begun and the fund is in "drawdown", or the individual is over age 75, the fund can be paid as a lump sum on death subject to 55% tax. Alternatively, a surviving spouse may continue with the drawdown arrangement, paying income tax at their marginal rate.

New rules from 6 April 2015

The new rules will apply to payments settled after 5th April 2015, even if death occurred before then.

Where an individual is under age 75 at date of death, their pension fund can be paid out after 5th April 2015 free of tax whether in drawdown or not. The fund can be taken as a tax-free lump sum or, should a dependant decide to carry on with drawdown, as tax free income.

Where death occurs after age 75, the lump sum death charge reduces to 45% from 55% in 2015/16, with the intention that the recipient's marginal rate of income tax applies from 2016/17. Where the dependant chooses to carry on with drawdown, their income will be taxed at their marginal rate.

Comment

Any reduction in a seemingly excessive tax rate is to be welcomed. The 55% death tax charge often means that currently people defer taking their retirement benefits until age 75, running down non-pension assets in the meantime. The abolition of the death charge will allow more flexible planning.

It is regrettable that the tax break given to dependant's drawdown income is not being extended to a dependant's annuity on death before age 75. There is a concern that this, in conjunction with other "anti-annuity" measures announced in the Budget, will see people overlook the risk of living too long and failing to include sufficient guaranteed income into their retirement planning.

It is important to stress that the changes do not alter the fact that, should a pension fund be paid to an individual's estate on death, the fund will still be liable to inheritance tax. If inheritance tax is to be avoided, it is essential that a pension plan is held in trust. Modern personal pension plans, including drawdown arrangements, are almost certainly held under the pension provider's master trust. However, certain pension plans are not trust based; notably "buy-out" or "section 32" policies and pre July 1988 personal pension plans (also known as "retirement annuity policies"). Unless steps are taken to put these policies into trust, these funds may be liable to inheritance tax regardless.

If you think you might be impacted by these changes and would like to discuss what the implication is for you, please contact your usual Blick Rothenberg contact, or
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