ADVISER FACTSHEET

JAMES HAY PARTNERSHIP

Tech Talk

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Death benefits: annuities

The Finance Act 2015 contains further changes in connection with death benefits post 5 April 2015. The purpose of the legislation is to extend the payment of annuities to beneficiaries on the death of pension scheme members, as well as amending the tax treatment of payments made under such annuities. The extension and amendments broadly mirror the drawdown changes introduced by the Taxation of Pensions Act 2014.

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For professional advisers only

Definitions

As a preamble to what follows, please note the following:

A beneficiary can be a dependant, nominee or successor of the member.

A nominee of the member means an individual nominated by the member, or nominated by the scheme administrator who is not a dependant of the member. However, no individual nominated by the scheme administrator counts as a nominee, at any time, when there is a dependant of the member, or an individual or charity has been nominated by the member.

Successor of the member means an individual:

- nominated by a dependant of the member
- nominated by a nominee of the member
- nominated by a successor of the member, or
- nominated by the scheme administrator

In relation to any particular benefits under an arrangement relating to a beneficiary, no individual nominated by the scheme administrator counts as a successor of the beneficiary when there is an individual, or charity nominated by the beneficiary.

The term drawdown is used to cover both capped and flexi-access drawdown.

Death benefit options

On the death of a member on or after 3 December 2014 it may be possible to use their remaining money purchase pension fund (or part of) to purchase, on or after 6 April 2015, an annuity for a nominee. The potential recipient of an annuity bought from a deceased member's fund is therefore being extended beyond a dependant of the deceased member, which is the only option currently.

On or after 6 April 2015 it will be possible for a member of a money purchase arrangement to buy an annuity that can continue to be paid on their death, other than by way of remaining instalments under a guarantee period, to a nominee.

In both cases the nominee can continue to receive income payments from the annuity until they die or until the earliest of the nominee marrying, entering into a civil partnership or dying.

Where a dependant or nominee inherited the pension fund of a deceased member in the form of a drawdown pension, on the death of the dependant/nominee on or after 3 December 2014 it will be possible to use the remaining drawdown fund, post 5 April 2015, to secure an annuity for a successor.

Where a successor inherited the pension fund following the death of the dependant/nominee in the form of a drawdown pension, on the death of the successor it will be possible to use the remaining drawdown fund to secure an annuity for another successor.

Income payments from a successor's annuity can continue until they die or until the earliest of the successor marrying, entering into a civil partnership or dying.

The taxation of the annuity payments is dealt with below.

New benefit crystallisation event (BCE)

BCE 5D will capture uncrystallised funds designated post 5 April 2015, following the death of a member on or after 3 December 2014 and where the member had not attained age 75, to purchase an annuity for a dependant or nominee. Only funds designated within two years of when the scheme administrator could have reasonably known of the member's death will be caught under BCE 5D.

Funds that are in excess of the deceased member's remaining lifetime allowance being used to purchase an annuity for a dependant/nominee will be subject to a lifetime allowance charge of 25%. The recipient i.e. dependant/nominee will be liable for this charge.

Taxation of the beneficiary annuity payments post 5 April 2015

Member dies on or after 3 December 2014 under age 75:

Payments from annuities purchased using uncrystallised funds that are designated within the two year period referred to above will be free from income tax. This assumes that where the member died before 6 April 2015 no annuity payments are received by the dependant/nominee before that date.

Payments from annuities purchased using uncrystallised funds designated outwith the two year period referred to above will be taxed at the dependant's/nominee's marginal rate of income tax.

Payments from annuities purchased using the drawdown funds remaining on the death of the member will be free from income tax provided no payments are made before 6 April 2015.

Where the annuity for the dependant/nominee is purchased together with the annuity for the member (dependant/nominee annuity starts on the death of the member) any annuity payments made to the dependant/nominee will be free from income tax provided no payments are received prior to 6 April 2015.

Where payments under an annuity continue beyond the member's death under a guarantee period, the payments made for the remainder of the guarantee period will be free from income tax provided these are paid on or after 6 April 2015.

Member dies on or after age 75:

Annuity payments received by the dependant/nominee will be taxed at their marginal rate of income tax.

Beneficiary dies on or after 3 December 2014 under age 75:

Where drawdown funds remain on the death of the beneficiary and are used to purchase an annuity for a surviving beneficiary, the annuity payments made post 5 April 2015 will be tax free provided no payments are made to the surviving beneficiary before 6 April 2015.

Beneficiary dies on or after age 75:

Annuity payments received by the surviving beneficiary will be taxed at their marginal rate of income tax.

Taxation of beneficiary short term annuity payments post 5 April 2015

A short term annuity purchased from a drawdown fund is classed as drawdown. The Taxation of Pensions Act 2014 deals with the tax treatment of income withdrawal payments made to beneficiaries under drawdown. However, it does not cover the tax treatment of all forms of drawdown payments, in particular, payments made to beneficiaries under short term annuities. Clauses in the Act rectify this.

Member dies on or after 3 December 2014 under age 75:

Annuity payments made to a dependant/nominee post 5 April 2015 will be free from income tax provided no payments are made to the dependant/nominee from the drawdown fund prior to 6 April 2015.

Note that where uncrystallised funds designated for dependant/nominee drawdown post 5 April 2015 are designated outwith the two year period referred to above, payments from a short term annuity purchased using the dependant's/nominee's drawdown fund will be taxed at the dependant's/nominee's marginal rate of income tax.

Member dies on or after age 75:

Annuity payments received by the dependant/nominee will be taxed at their marginal rate of income tax.

Beneficiary dies on or after 3 December 2014 under age 75:

Annuity payments post 5 April 2015 under a short term annuity purchased from the surviving beneficiary's drawdown fund will be free from income tax provided no payments are received prior to 6 April 2015.

Beneficiary dies on or after age 75:

Annuity payments received by the surviving beneficiary will be taxed at their marginal rate of income tax.

Comment

This legislation was promised at the time of the Chancellor's autumn statement (3 December 2014) and therefore comes as no surprise. It is welcome, as it ensures that annuities as a death benefit option are a valid alternative to drawdown for risk averse beneficiaries in need of a regular income stream.

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