

Why Do I need to put Pension and/or death benefits into Trust?

The considerations that you need to make when taking the important step of protecting your death benefits of your pension and DIS.

- How important is remarriage protection for the surviving spouse to you?
- How important is care fee protection for the surviving spouse to you?
- How important is it to legitimately avoid the unnecessary payment of future Inheritance Tax (IHT) and Income Tax by your Beneficiaries?
- Flexibility and guarantee of how your death benefits are used (particularly important for clients who may have been previously married).

If the answer is yes to any one of these considerations then your family will benefit from Trust planning and not doing so could prove to be highly detrimental.

Your Death in Service (DIS)

Like many people you may have a company DIS benefit which is intended to support your spouse and children for the long term. The payment is a tax-free payment that passes to the nominated Beneficiary. If the payment passes directly to a Beneficiary it is regarded as being part of their estate and should they remarry the new partner would have a claim on the benefits intended for your spouse and children. Similarly a local authority would take the sum into account for care fees. Worst still when your spouse dies it may push your spouse into an IHT bracket, of which HMRC will be grateful in taking 40% of the sum or could increase the estate and impact the ability to fully benefit from tax allowances such as the new Residential Nil Rate Band. Lastly when your children do inherit the reduced sum it could be unprotected from their partners.

So few people take the easy step of avoiding these possibilities by setting up a family controlled protective Trust (Asset Preservation Trust), which is recognised by the financial planning industry as the approved solution for DIS benefits. This is largely because many clients are not advised of the threats and it is all too frequently neglected by legal advisers. You now have the facts and the solution so you just need to decide if you wish to invest now in protecting your family death benefits and act.

Your Pension Plan Death Benefits

A rapidly reducing number of people have final salary schemes that end on death or the death of the partner and there are no transferable benefits or lump sum payments. Many more people now have their own pension arrangements that have been built up over the years. The purpose is to provide as much as possible a guaranteed income for both of you. There have been a number of changes recently which directly impact the protective position of pensions as well as the tax position of Beneficiaries. There have been a lot of statements by politicians, superficial media articles and unbalanced financial adviser “education” which at best is providing the vast majority of people with a “rosy” picture of pension progress, which is clouding the essential protective benefits which are being lost in the financial hype.

The three considerations are divorce/remarriage and care fee protection, future IHT and income tax by Beneficiaries and flexibility/guarantee of how death benefits are ultimately directed.

Protection Pre Age 75.

If you die pre 75, whether you crystallised your pension or it is untouched it can pass to your nominated Beneficiary either as a lump sum or a transfer of the fund by the provider to a new pension Plan for your spouse. Advice will need to be taken with the provider wanting to keep funds under management “tax free” but there will be many reasons to look at planning around the lump sum benefits with your financial planner.

Whatever route is taken the benefits will be exposed to remarriage/divorce or care fee assessment. The solution will be to direct the lump sum death benefits into a family controlled protective Trust (Asset Preservation Trust).

From our conversations during our previous meeting, it was clear that in the event of XXXX death that you wanted XXXX to benefit from the death benefits. This is simply done, by making a nomination with the pension provider to say that this is how the death benefits should be passed. While pension schemes are not under any compulsion to comply with your wishes, it would be highly unlikely and irregular for them not to take account of your wishes.

Issues with direct nomination

When nominating a direct Beneficiary, the pension death benefits pass to them. Potentially, there could be a third party claim on the benefit received by the nominated spouse and subsequently the children. In addition, there could be a tax problem for the children when the surviving spouse dies.

The solution is to use an Asset Preservation Trust up until age 75.

This current pension regulation allows the use of an Asset Preservation Trust to protect and “ring fence” pension assets, as well as death in service assets if they are provided by an employer.

The Asset Preservation Trust is a specifically designed settlement that wraps itself around the death benefits provided by pension schemes and death in service benefits.

The Trust is established during your lifetime, and the death benefits on the pensions are directed to the Trust. The Trust would then hold the benefits for the Beneficiaries. They can receive income, capital or loans based on our advice at the required time.

When establishing the Trust you note who the Beneficiaries will be, for example your widow (not wife/husband!), children, grandchildren, etc. At the same time you appoint Trustees (including yourself).

On your death (before age 75) the pension death benefits are directed into the Trust for the benefit of the Beneficiaries, and are controlled by the Trustees. The Trustees will then allow income and or capital to pass to the Beneficiaries as required. In reality XXXX would be a Trustee and Beneficiary and so could direct money to him/her and thus ensure that income is provided throughout their lifetime. Following his/her death, the assets that remain in the Asset Preservation Trust, would pass to the other chosen Beneficiaries.

As the pension benefits are held in the Trust, they do not enter anyone's estate. This provides two very real benefits:

1. The value of the pensions cannot be liable to future taxes which can occur should a nominee reach age 75.
2. The value of the pensions offers essential protective benefits (care fees, divorce etc.).

The effect of this is to “ring fence” the pension death benefits and protect them long-term for the Beneficiaries.

On-going considerations

Until death, there is little that the Trustees or anyone must do with the Trust, as it would only hold a nominal £10 in value.

Following death, the Trust will hold the pension lump sum death benefits. These benefits will then need to be managed by the Trustees. The Trustees can either hold the money on deposit, or can invest them. The Trust deed will be written very widely so that any sensible investment can be used. The Trustees can also obtain and seek advice for the investment of the money if they wish.

The Trust would be taxed, based upon the type of assets held. Therefore if Income Tax is payable, perhaps because the money is held on deposit, an income tax bill will be generated each year. For this reason, every year following death, a tax return will need to be completed.

A further consideration is the effect of the “periodic charge”. The periodic charge is a tax charge that is made on most Trusts every 10 years. It is presently payable at 30% of the lifetime rate, which is presently 20% (making a charge of 6%). The tax charge may be payable on all assets over the level of the “Nil Rate Band” (NRB), currently £325,000.