Pensions and Intergenerational Wealth Transfer

ANDREW ZANELLI

Head of Technical Engagement

TONY DAVIES

Technical Engagement Consultant

SYNOPSIS

Intergenerational wealth planning since 2015 will now involve considering a clients pension wealth alongside the traditional free estate approach. Recent figures show that there is over £6.1 trillion held in private pension wealth in the UK. A significant number of clients are now viewing a pension as an intergenerational wealth transfer tool as opposed to the traditional income replacement route. The session looks to explore:

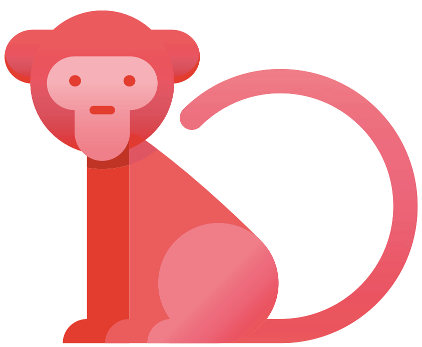
* What are the key considerations when looking to protect pension wealth through the generations?

* Is it time to consider a blended approach to death benefits to give control and protect your family?

* What are the tax considerations to discuss for this type of planning?

LEARNING OBJECTIVES

- Explore Pension death benefit options and the importance of nominations
- Discuss By-pass trusts, when would you consider their use
- Consider when could a pension arrangement potentially become subject to IHT?



Pensions and Intergenerational Wealth Transfer

Intelligent Partnership
IHT & Estate Planning Masterclass

Andy Zanelli / Tony Davies

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abrdn.com

This presentation is directed at Professional Financial Advisers only.
It should not be distributed to or relied upon by retail clients.

Learning Objectives

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- Discuss By-pass trusts, when would you consider their use.
- Consider when could a pension arrangement potentially become subject to IHT?

Delivering better outcomes for clients' loved ones

Question 1

How do the “pension freedom” rules help Theo Jnr and Ingrid achieve their aims?

Flexible pension death benefits

A changed wealth transfer planning framework

Two of the 2015 changes to pension death benefit rules have revolutionised the role modern, flexible DC pensions play in wealth transfer planning

Less Tax

- Death before 75: All benefits from DC paid tax free (within notional LTA)
- Death 75+: Benefits taxed as recipient's income (45% for trusts)
- IHT: Pension death benefits are normally free of IHT

More Choice

- Anyone nominated can now inherit a drawdown pot on death
- And it can be cascaded to their loved ones when they pass on
- But only under a modern, flexible DC pension

These have rewritten the wealth transfer planning equation

The role of death benefit nominations

Making wishes known without triggering IHT

Under most modern pensions, the trustees/ scheme administrator decide who any death benefits are paid to (and how)

- This discretionary control protects death benefit payments against IHT

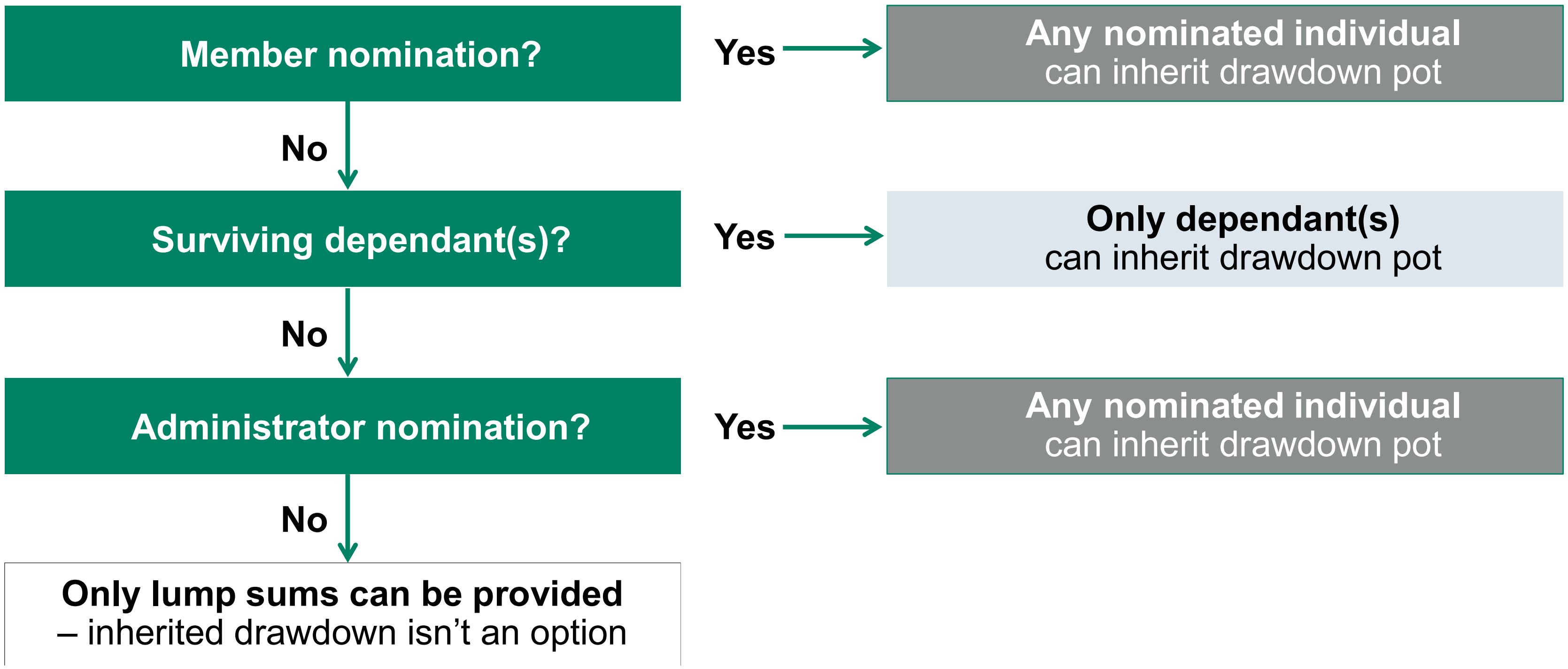
But the trustees will take account of the deceased's wishes

- A nomination allows the client to tell the trustees their aims and wishes
- Trustees will be guided by this, and a fact find, in deciding who gets what
- As long as they act honestly and reasonably, and reach their decision fairly after making proper enquiries, it can rarely be challenged

Giving a clear nomination helps deliver the desired outcome

The importance of nominations

Non-dependants and inherited drawdown – keeping options open



Lump sum payments

- Serious ill-health lump sums.
- LTA excess lump sums.
- Defined benefits lump sum death benefits, and
- Uncrystallised funds lump sum death benefits.

- These were tax free up to the LTA, and then 55% on the excess.
- From 6 April 2023, they'll still be tax free up to the individual's LTA and then taxed at the recipient's marginal rate of income tax on the excess.
- Unless the scheme holds a P45 for the recipient, then emergency tax will be applied.

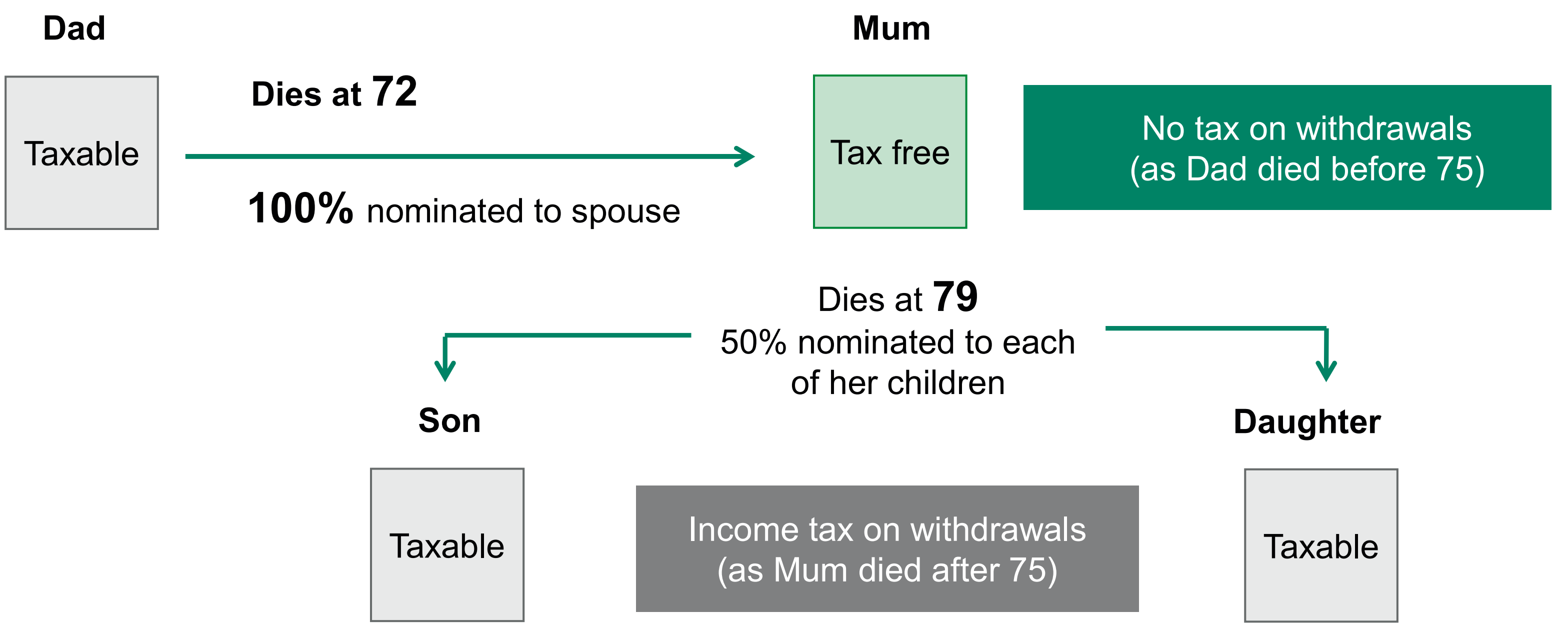
Uncrystallised funds lump sum death benefits

- The excess is taxable as pension income at the beneficiaries marginal rate of income tax.
- This will count as adjusted net income for tax allowances and adjusted income for annual allowance tapering.
- Would beneficiaries drawdown be a better option? No income tax on the excess or on withdrawals.

Age at death	**70**	
LTA excess	£200,000	
Income tax charge	**Beneficiaries drawdown**	**Lump sum Additional rate**
	£0	£90,000 (45% x £200,000)
Net excess fund available for beneficiaries	**£200,000**	**£110,000**

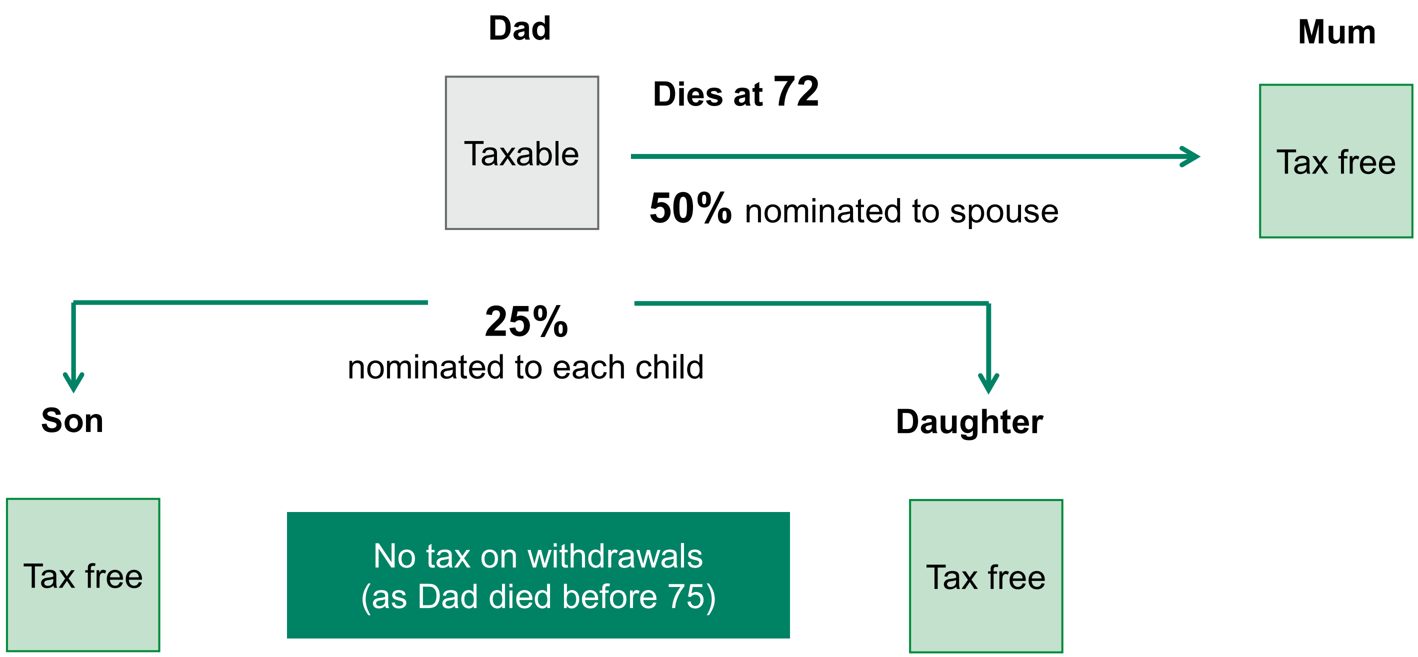
Inherited drawdown and income tax

Conventional nomination to spouse



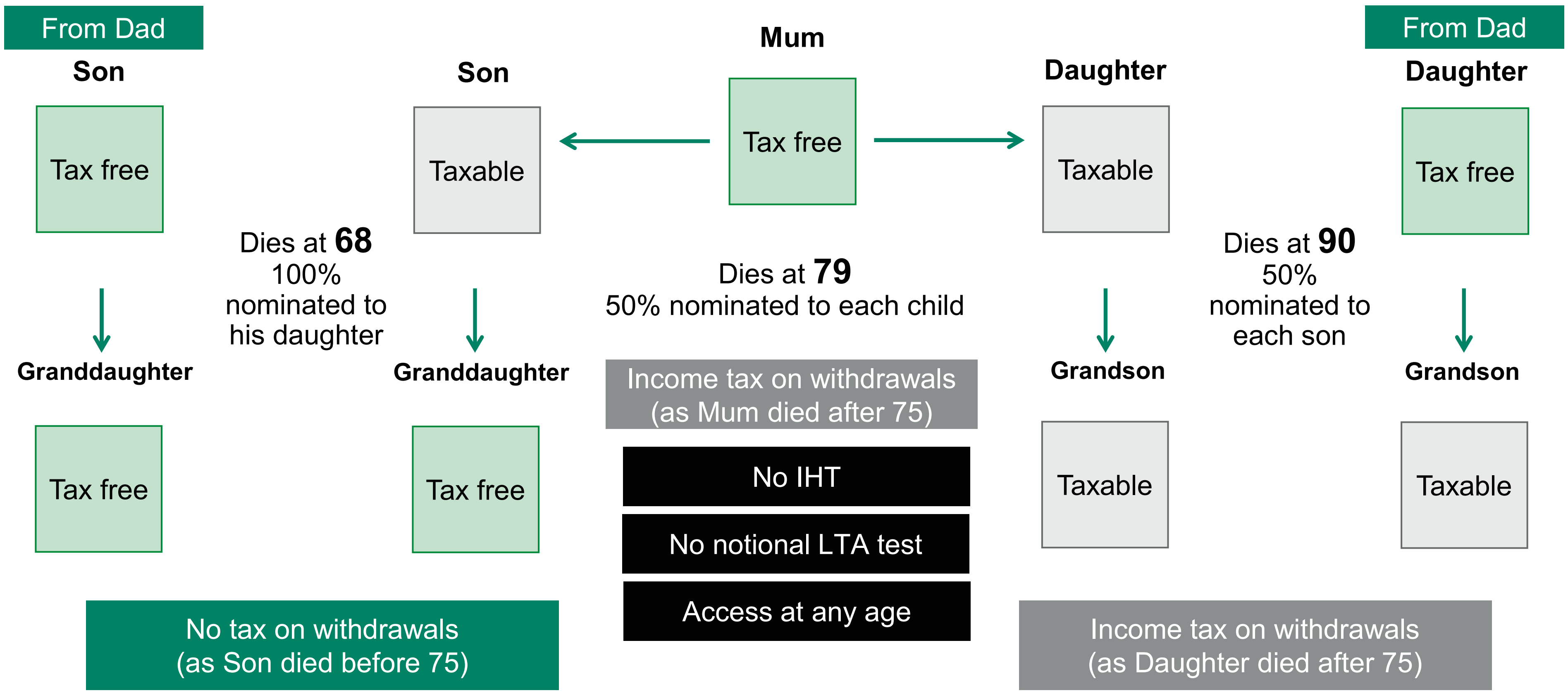
Inherited drawdown and income tax

Alternative ‘family’ nomination



Inherited drawdown and income tax

'Family' nominations: cascading the wealth



Question 2

Why might Theo Jnr and Ingrid consider using a Bypass trust for pension death benefits?

Pension Bypass trusts

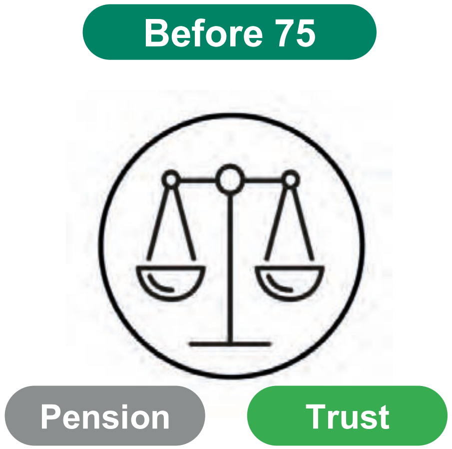
What are they?

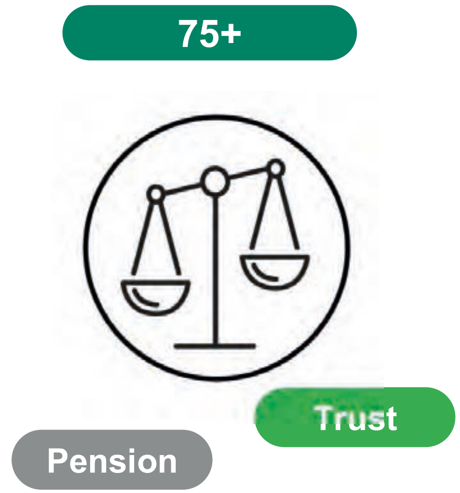
- Pilot discretionary trust that can receive pension death benefits
- Created with nominal property (e.g. £10 or postage stamp)
- Bypass trust nominated to pension scheme trustees
- Client chooses bypass trustees
- Trust fund held for wide class of beneficiaries
- Bypass trustees decide who will benefit and when

A pilot trust created post 6 October 2020 will need to register on the TRS

Inherited drawdown or bypass trust?

Balancing tax and control





Inherited drawdown should meet most clients' needs.
But bypass trusts still have an important role to play.

Inherited drawdown or bypass trust?

Taxation

Inherited drawdown	Bypass trust
• **Below 75**: Beneficiary can access pension pot tax free • **75+**: Beneficiary pays income tax on withdrawals (when/ if taken) • Tax reset, and can change, each time the pot is passed on (so a taxable pot can become tax free and vice versa) • No tax on fund growth or income	• **Below 75**: Lump sum paid to trust tax free • **75+**: 45% tax deducted from lump sum paid to trust (with 45% tax credit) • Tax on payments to beneficiaries (but can normally reclaim tax deducted from original lump sum paid to trust) • Tax on fund growth and income (can use non-income producing assets to mitigate this tax - Offshore Bond?)
• Full IHT protection within pension wrapper	• IHT periodic and exit charges • Loans can reduce beneficiary IHT

These have rewritten the wealth transfer planning equation

Inherited drawdown or bypass trust?

Control

Inherited drawdown

- Pension trustees control who inherits pot (based on nomination)
- Beneficiary decides what to draw (and when) – can erode pot
- Beneficiary controls investment
- Robust asset protection on bankruptcy (and divorce, in most cases)
- Ability to cascade through, or skip, generations within pension wrapper
- Beneficiary nominates who inherits pot on their death

Bypass trust

- Client chooses their own trustees, who know them and their circumstances
- Client's appointed trustees control who gets what (and when)
- Trustees control investment
- Robust asset protection on bankruptcy or divorce
- Ability to manage complex circumstances or cater for vulnerable or spendthrift beneficiaries

Bypass trust

Which clients?

Death before 75?

Complicated family circumstances?

Young or vulnerable beneficiaries?

Beneficiary not good with money?

Assess each case on its merits – it doesn't have to be all or nothing.
Consider split nomination between inherited pension(s) and bypass trust?

Revisit nominations regularly and always at 75

Question 3

In what circumstances could a pension arrangement be potentially liable to IHT?

Pension death benefits

Inheritance tax (IHT)

The modern pension wrapper (normally) provides robust IHT protection

Pension IHT traps to watch out for:

Transfers	• Transfers in ill-health can bring pensions back into the estate • Reportable on death within 2 years and **no spousal exemption**
Contributions	• Personal contribution, if in ill-health could be treated as a 'transfer of value'
Old pensions	• Some older pensions are always included in the estate on death • Check retirement annuities and buy-outs (if not under trust)
Gifts	• Gifts of surplus income are immediately outside estate • But what is ‘surplus income’ under flexi-access drawdown?

Review the IHT aspects of your clients’ pension planning

Pensions and IHT

The transfer trap

Modern flexible DC pensions (normally) provide robust IHT protection

But transfers in ill-health can have IHT implications

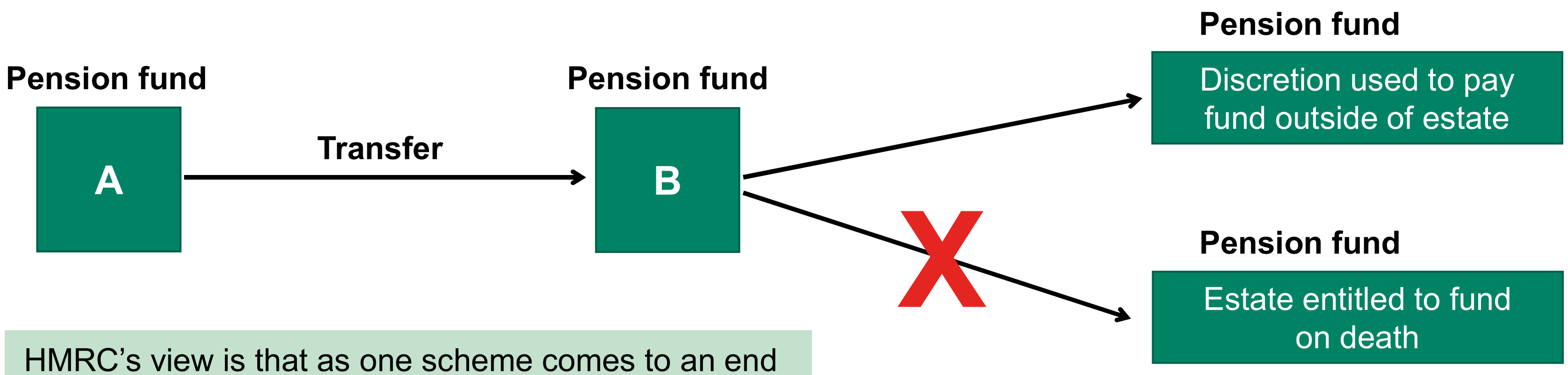
- All transfers within 2 years of death must be reported to HMRC (IHT409).
- If the client knew when they transferred that they were unlikely to survive to enjoy the benefit, HMRC may treat it as part of their estate for IHT.
- And there's no inter-spousal exemption.

This means a pension transfer can bring a pension pot that was sheltered from IHT under the old pension, back inside the IHT net.

- The Supreme Court ruling in the 'Staveley case' has called into question HMRC's approach to pension transfers in ill-health.
- To date HMRC have not published any fresh guidance on how transfers will be valued in light of the judges' comments that they did not agree with HMRC's process

Pension transfers and IHT

Why is there a transfer of value for IHT purposes? – HMRC’s position



HMRC’s view is that as one scheme comes to an end the member makes a fresh gift of the rights of the death benefits to the new scheme.

In theory the member could have chosen a pension that allows death benefits to be paid to their estate, however unlikely.

As a consequence, there is a loss to the estate when the transfer is made to the new scheme.

Normally the value of the death benefit is negligible because most transfers are done when the individual is in good health and they are expected to survive long enough to take their retirement benefits.

This is not the case where someone is in ill health at the time of the transfer and dies shortly afterwards.

Pension transfers and IHT

The transfer of value for IHT is the deemed loss to the estate from the pension transfer

The deemed loss to the estate is the difference between:

- the **open market** value of the individual's rights **before** the pension transfer and
- the **open market** value of the individual's rights **after** the pension transfer

If the open market value is lower after the pension transfer, the difference will be included in the estate for IHT purposes

Pension transfers and IHT

Our key messages

1. Pension transfers in ill-health can create IHT liabilities (so its safer from an IHT perspective to transfer when still healthy)
2. Any valuation for IHT purposes will normally be less than the transfer value paid to the new pension
3. Even with a potential extra IHT liability, a transfer may still support a better client outcome than staying in the current pension

Ensure clients transferring in ill-health understand this IHT risk.
But focus on delivering the **right client outcome** - not the tax.

Pension structures and bypass trust

Contract or trust-based pension?

The IHT treatment of pension bypass trust assets depends on the structure of the pension scheme that the lump sum death benefit came from.

Contract-based pension

- Retirement annuities ('s226/ RAC')
- Buy out plans ('s32')
- Personal pensions?
- Stakeholder pensions?

Trust-based pension

- Occupational pensions
- (DB, TBP, CIMP, SSAS, EPP)
- SIPP?

For general guidance only

If in doubt, always check with the pension provider

IHT and the bypass trust

Multiple settlements and periodic charges

EPP
Jul 1993
£400,000
(50%)

SIPP
May 2005
£320,000
(40%)

CIMP
Oct 1986
£80,000
(10%)

Bypass Trust
£800k

4 settlements within the bypass trust, with their own periodic charge dates

EPP
50%
Jul 2023
Jul 2033

SIPP
40%
May 2025
May 2035

Bypass Trust

CIMP
10%
Oct 2026
Oct 2036

10%
Oct 2026
Oct 2036

You need to track the number of settlements within the trust and what proportion came from each pension settlement

Flexible pension death benefits: summary

A new wealth transfer planning equation

Inherited drawdown or lump sum

- Death before 75: tax free (within notional LTA)
- Death at 75+: income tax (45% for trusts)
  – when (if) benefits are taken
- Can cascade inherited drawdown on beneficiary death (tax rate reset based on their age at death)

Charity lump sums – tax free after 75

- If nomination and no dependants

No IHT on pension death benefits (normally)

- Transfers in ill-health can bring pension into estate
- Watch older pensions (RAC/buy-out) – in estate (unless under trust)

Bypass trust

- Gives more control over who gets what when
- Useful option to manage more complex situations
- Extra control may cost more in tax and admin

Gifting tax free cash

- Unused funds taxable on death after 75
- Outright gift or via a trust (PET v CLT)
- IHT treatment of alternative wrapper?

Gifting surplus pension income

- Immediately outside estate for IHT
- IHT treatment of alternative wrapper?

Flexible pensions – the family wealth management plan?

Flexible pension death benefits

Wealth transfer considerations

Inherited drawdown

- Access at any age
- No test against beneficiary's notional LTA – ever
- Beneficiary can nominate their loved ones to inherit on death

Bypass trust

- Gives more control over who gets what – and when
- But extra control may come at the price of more tax
- Still has a role to play – but more niche than before 2015?

Nominations

- Review in light of the new rules to support right outcome
- Nominations based on old rules are unlikely to be appropriate
- Revisit nominations to bypass trust as a priority (especially if binding)

Revisit death benefit nominations and income strategy

Flexible pension death benefits

Key advice points

Right Pension?	Right Nomination?	Right Time?
• Are your clients' retirement savings in modern flexible pensions? • Do they give all the death benefit flexibility your client needs? • Consider consolidating older pensions if they don't!	• Review existing nominations in light of new rules/options? • Name non-dependents so they can inherit drawdown • Revisit nominations regularly – and always at age 75!	• Dying in the wrong pension or with the wrong nomination may mean your clients' wishes cannot be met • Transfers in ill-health can have IHT complications • Don't delay – review your clients' pensions now!

Get your clients' pensions in shape for every eventuality

Learning Objectives

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Delivering better outcomes for clients’ loved ones

Legal and regulatory information

Any advice you give is your responsibility

This presentation is based upon abrdn's understanding of UK law and HM Revenue & Customs practice in the UK as at April 2023.

- Tax and legislation are likely to change. Tax treatment depends on individual circumstances.
- This presentation is designed as educational support for authorised advisers and should not be relied upon by anyone else.
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