PRUDENTIAL

Lump sum death benefits over the Lifetime Allowance

This leaflet covers the position on death before age 75 and explains

- the effect of legislation on the payment of lump sum death benefits,
- possible tax liability for anyone receiving lump sum death benefits and
- the new responsibilities for Personal Representatives*.

Different rules apply on death after age 75.

* A Personal Representative, in relation to a person who has died, is responsible for administering the estate of the deceased.

Lump sum death payments after 5 April 2006

- From 6 April 2006, the Government introduced an overall Lifetime Allowance. This will remain at £1.80 million until 5/4/2012, when it will be reduced to £1.50 million. Protection may be available (or may already have been applied for and granted by HMRC) for those that may exceed the Lifetime Allowance.
- There will be a Lifetime Allowance Charge, a tax charge, on any excess of the total lump sum death benefits from pension plans over the deceased person's available Lifetime Allowance.
- There will also be penal tax charges where death benefits are not paid within 2 years of the earlier of
  - the day the Scheme Administrator first knew of the death; and
  - the day the Scheme Administrator could first reasonably have been expected to know of the death.

This leaflet is based on our current understanding as at March 2011 of current taxation legislation and HM Revenue and Customs practice, all of which are liable to change without notice. The impact of taxation (and any tax reliefs) depends on individual circumstances. It is not intended to provide legal advice and we recommend that readers obtain specific legal advice before taking any action.

Deaths Before 6 April 2006

- There are transitional rules that can be applied where death was before 6 April 2006. These transitional rules mean that it will be possible to apply the old rules, provided payment will not breach the old rules and the benefit is paid in accordance with the 2 year guidelines detailed in the previous section. This may avoid a Lifetime Allowance Charge.
- For most pre-6 April 2006 deaths, it will be more advantageous to apply the new rules. However, where the death was before 6 April 2004 and the scheme administrator knew of the death prior to this date, the old rules must normally be applied.
- Where a pension under the old occupational scheme rules started before 6 April 2006, there may be a death lump sum payment if the pensioner dies within 5 years of the start of the pension – "a 5-year guarantee". Any lump sum death benefit paid after 5 April 2006 in respect of this kind of guarantee will be exempt from the new rules.

You can ignore this leaflet if

- the benefits, from all UK private pension plans, are under the Lifetime Allowance (as will be the case for most people) AND
- all lump sum death benefits are paid within the 2 year timescale mentioned above.

Lump sum death benefits over the Lifetime Allowance –

Importance of this leaflet

Anyone getting a lump sum death benefit from a pension plan (a beneficiary) will have some tax to pay if the total lump sum death payments are over the Lifetime Allowance.

If you are a Personal Representative, you have special additional responsibilities to report payments over the Lifetime Allowance to HMRC.

In practice, the Lifetime Allowance tax charge will not often apply: this tax applies only where large funds are involved.

If you think a Lifetime Allowance Charge will apply, you should read this leaflet.

Questions & Answers

Q. Why is there tax on lump sums from pension funds now?

A. The Government changed the rules on the benefits that can be paid from pension schemes from 6 April 2006. There is no limit on benefits that can be paid from pension plans unless the total value is over the Lifetime Allowance. In practice, this tax should not affect many people as the Lifetime Allowance is set at a high level.

If the post-5 April 2006 rules have to be applied, the value over the Lifetime Allowance is called the chargeable amount. There is a special tax charge of at least 55% on the chargeable amount, called a Lifetime Allowance Charge.

However, any lump sum death benefits used to provide pension income for a surviving spouse/civil partner/dependant do not count towards the Lifetime Allowance. So tax may be avoided or reduced by buying a pension income with all or some of the lump sums payable that are in excess of the members available Lifetime Allowance.

There are other lump sums payable on death from some types of pensions where there is a "special lump sum death benefits charge" of up to 55%. These are:

- a lump sum death benefit from income drawdown/an unsecured pension fund,
- an annuity protection lump sum death benefit, or
- a pension protection fund lump sum death benefit.

The scheme administrator making these types of lump sum payments will confirm when/if a special lump sum death benefits charge applies and arrange for deduction before payment.

As these lump sums will already have been tested against the lifetime allowance when the pensions came into payment and have already been taxed they are not included in the total lump sum death benefits paid for the purposes of establishing if a chargeable amount arises.

Q. What about Inheritance Tax?

A. Pension funds do not normally attract Inheritance Tax.

However, Inheritance Tax may apply where the scheme administrator has no discretion on who benefits are paid to on death.

Also, it could apply where someone who is expected to live for less than 2 years:

- alters the terms of their pension contract, or
- makes unusually large contributions, or
- places the plan under trust.

Inheritance Tax and Pensions is a complicated area and independent advice from a solicitor, tax or financial adviser is recommended if you believe Inheritance Tax could apply.

Q. Could Inheritance Tax and the Lifetime Allowance Tax Charge both apply?

A. Yes, in exceptional circumstances, if a lump sum payment forms part of the deceased's estate and a Lifetime Allowance Charge applies.

Q. Are there any other tax charges?

A. If benefits are not paid within two years (see the "The Lump Sum Death Payments After 5 April 2006" section for further details), these will be subject to a tax charge of up to 70%, normally deducted before payment.

If this happens the payment is "unauthorised" and the lump sum will not be included in the total value of lump sums when determining if a chargeable amount arises.

Questions & answers for those who get a lump sum

Q. Will I have to pay any tax?

A. Yes, where a Lifetime Allowance Charge applies, each person who gets a lump sum payment is responsible for his/her share of the tax on the total benefit over the Lifetime Allowance. If you get the whole lump sum, you are responsible for the full tax charge. If you share the benefits, say you get half, you are responsible for half the tax charge.

Any benefits not paid within the required timescale will be subject to a tax charge of up to 70%, normally be deducted before payment.

There may also, in exceptional circumstances, be a liability for Inheritance Tax.

Q. How will I know if a Lifetime Allowance Charge is due?

A. The Personal Representatives are responsible for working this out and for telling HMRC.

HMRC has 6 years from the date they are told about the chargeable amount to claim the tax from beneficiaries.

If there is tax to pay, HMRC will expect payment within 30 days of the request for payment.

There are examples at the end of this leaflet to help work out if there is a Lifetime Allowance Charge.

Q. Will Prudential be able to tell me if there is a Lifetime Allowance Charge?

A. No. The Legislation gives this responsibility to Personal Representatives. In any event, there could be benefits from plans where Prudential has no involvement.

Q. Why is it the beneficiaries who pay the tax?

A. The Government decided that, if tax is due, each person receiving lump sum death benefits must pay the appropriate share of the tax due.

Questions & answers for personal representatives

Q. Are we responsible for paying the Lifetime Allowance Tax Charge?

A. No, the people who receive lump sum(s) from the pension plans have to pay the tax.

Q. What are our responsibilities?

A.
- Gather enough information about the deceased's pension funds to work out if there is a Lifetime Allowance Charge.
- Work out the value of the Lifetime Allowance Charge.
- Where there is a Lifetime Allowance Charge, send details to HMRC.

Q. Where will I get the information to check for liability for a Lifetime Allowance charges?

A. You'll get details from the pension provider/scheme that was paying the pension to the deceased and that paid any lump sum death benefits. The deceased's personal papers may also help.

Q. Will I need special authority to get information about the pension funds?

A. No, registered pension schemes and pension providers must give Personal Representatives information about the deceased's pension plans to work out if any tax is due.

The scheme or company will need to be satisfied that you are the Personal Representative.

Q. What benefits need to be taken into account?

A. Lump sum death benefits:

The total value of lump sum death benefit payments from registered pension schemes, including individual pension plans.

Existing pension income:
Any income the deceased was receiving from pension schemes/ plans also needs to be taken into account. The value of these benefits should be calculated as follows:

- The percentage of the Lifetime Allowance used for each pension and each income drawdown/ unsecured pension plan started after 5 April 2006. The pension provider/scheme will have confirmed this percentage figure when the pension started, and in later statements or P60 forms. If you do not have access to this information, each pension provider/scheme should be able to help.
- The value of a pension that started before 6 April 2006 is calculated as 25 times the yearly rate at the date of death. However, if the deceased took any benefits after 5 April 2006, the value for death purposes is 25 times the yearly rate when those benefits were taken.
- The value of income drawdown/ unsecured pension plans started before 6 April 2006 is calculated as 25 times the current maximum income that could have been taken at the date of death. You will need to ask the product provider for this value. However, if the deceased took any benefits after 5 April 2006, the value for death purposes is 25 times the maximum yearly rate when those benefits were taken.

Questions & answers for personal representatives – continued

Q. Are any benefits excluded?

A. State Pensions and any pension being paid to the deceased as a result of someone else's death should be ignored.

Any lump sum death benefit used to buy a pension income for a spouse/civil partner/dependant is also ignored when calculating the value of benefits against the Lifetime Allowance.

Any benefits paid as unauthorised payments are excluded from the total value of lump sums paid.

Any lump sums paid from pensions income where a "special lump sum death benefits charge" has been applied, are not included in the total value of lump sums paid although the income they produced is included when valuing the amount of available Lifetime Allowance (see "What benefits need to be taken into account?" above).

Q. Is the Lifetime Allowance the same for everyone?

A. No, some people who had benefits over the allowance at 5 April 2006, or thought their benefits would eventually grow to over the allowance, may have applied for Enhanced or Primary Protection – to protect their benefits from a Lifetime Allowance Charge. A few people may have later adjustments to their Lifetime Allowance after 5 April 2006 or may not be entitled to the full Lifetime Allowance.

Q. How will we know if benefits have been protected?

A. The deceased should have a certificate from HMRC if protection applies. You could contact HMRC and ask them if you are uncertain whether protection applies.

Q. How do we work out the chargeable amount?

A. There are examples at the end of this leaflet to help work out if there is a Lifetime Allowance Charge.

Q. If there is a chargeable amount, what happens?

A. You will need to give the following details to HMRC:

- the name of the registered pension scheme or individual plan that paid the lump sum death benefits
- the scheme administrator's name and address
- the deceased member's name and National Insurance Number
- the amount(s) and date(s) of payments under each scheme/plan
- the chargeable amount, i.e. the value of the lump sum death benefits over the Lifetime Allowance
- the names of the beneficiaries (if known).

Q. When do we need to inform HMRC and how do we do this?

A. Personal Representatives should provide the information about the chargeable amount to HMRC within

- 13 months of the death or, if later,
- within 30 days of becoming aware that there is a chargeable amount.

HMRC guidance says that, where the requirement to provide the information arises later, the reporting period is extended to 30 months starting with the date of death. Where Personal Representatives do not discover the relevant information until more than 30 months after the death, the period for reporting is extended to 3 months following the discovery of the information.

There will be penalties for late reporting.

You should give HMRC these details, in writing to:

Pension Scheme Services,
HM Revenue & Customs,
FitzRoy House,
Castle Meadow Road,
Nottingham NG2 1BD.

Q. What happens after we've given the details to HMRC?

A. HMRC will get details of the beneficiaries from all the schemes/providers concerned and then work out how much tax is due from each beneficiary.

HMRC will then contact the beneficiaries to arrange for payment of the tax.

Further information

You may want to speak to a solicitor or financial adviser to guide you through the process.

There is information on the general responsibilities of personal representatives on the HMRC web site – www.hmrc.gov.uk/cto/customerguide/page1.htm

Information on the pension rules can also be found on the HMRC web site.

Examples to help you work out if there is a chargeable amount

Example 1

Two separate pension plans: pension started before 6 April 2006, plus lump sum death benefits

Mr Smith died on 6 January 2011 when the Lifetime Allowance was £1.80 million.

He had:

Scheme A: pension payments of £25,000 a year, started before 6 April 2006.

Scheme B: lump sum death benefits of £700,000.

Scheme A: multiply the pension by 25 (the basis that HMRC require)	= £625,000
Scheme B: the value of the lump sum	= £700,000
The Total Value is £625,000 + £700,000	**= £1,325,000**

To find out if there is a taxable amount, compare Total Value to the Lifetime Allowance.

The Total Value is below the Lifetime Allowance of £1.80 million and there are no other benefits.
So there is no chargeable amount to report to HMRC.

Example 2

Two separate pension plans: pension started after 5 April 2006, plus lump sum death benefits

Let's take the example above, except this time the pension from Scheme A started after 5 April 2006. The value of Scheme A is now a percentage of the Lifetime Allowance. Let's say it's 40%.

(The pension provider/scheme will have confirmed this percentage when the pension started and in yearly statements, possibly the P60 forms.)

The calculation is now slightly different. You first need to work out how much of the Lifetime Allowance is available. As 40% of the Lifetime Allowance was used by Scheme A, only 60% of the allowance is left for Scheme B, i.e. £1,080,000. Scheme A is then ignored, as the benefits have been taken into account in working out the available Lifetime Allowance.

Scheme B benefits are £700,000, but the available Lifetime Allowance is £1,080,000.

Benefits from Scheme B are below the available Lifetime Allowance and there are no other benefits. So there is no chargeable amount to report to HMRC.

Examples to help you work out if there is a chargeable amount – continued

Example 3

Two separate pension plans: an income drawdown/unsecured pension plan plus lump sum death benefits

Let's go back to example 1, except this time Scheme A was providing income drawdown/unsecured pension.

Mr Smith was taking an income of £25,000 per year when he died, but the maximum he could have taken was £30,000.

To value benefits from Scheme A, the maximum income (as opposed to the actual income being taken) is multiplied by 25.

So

Scheme A* is valued by multiplying the maximum income available by 25	= £750,000
Scheme B is simply the value of the lump sum	= £700,000
The Total Value is £750,000 + £700,000	**= £1,450,000**

To find out if there is a taxable amount, compare Total Value to the Lifetime Allowance.

The Total Value is below the Lifetime Allowance of £1.80 million and there are no other benefits.

So there is no chargeable amount to report to HMRC.

* Scheme A may also pay a lump sum from the fund that Mr Smith has left over, what is known as an "unsecured pension fund lump sum death benefit". This lump sum is not added to the amount of lump sums taken as it will have been subject to a "special lump sum death benefit charge" and as the example shows, the pension income which was provided by this lump sum is used in calculating if there is any available Lifetime Allowance.

Example 4

Two separate pension plans: an income drawdown/unsecured pension plan plus lump sum death benefits

Let's now take example 3 above, except this time Mr Smith had a 3rd scheme. There is a lump sum death benefit of £400,000 from that scheme.

So

Scheme A* is valued by multiplying the maximum income available by 25	= £750,000
Scheme B is the value of the lump sum	= £700,000
Scheme C is the value of the lump sum	= £400,000
The Total Value is £750,000 + £700,000 + £400,000	**= £1,850,000**

To find out if there is a taxable amount, compare Total Value to the Lifetime Allowance.

The Total Value is over the Lifetime Allowance of £1.80 million.

Subtract the Lifetime Allowance from the Total Value. £1,850,000 – £1,800,000 = £50,000.

This is the chargeable amount (£50,000) that needs to be reported to HMRC.

The beneficiaries of the lump sums would receive an assessment from HMRC for their share of the tax due. The tax the beneficiaries must pay is 55% of the chargeable amount, i.e. £27,500.

However, if the £100,000 is instead used to provide pension income for a dependant, say Mr Smith's widow, there would be no chargeable amount as lump sum death benefits used to provide pension income for a spouse/civil partner/dependant are not tested against the Lifetime Allowance.

* Scheme A may also pay a lump sum from the fund that Mr Smith has left over, what is known as an "unsecured pension fund lump sum death benefit". This lump sum is not added to the amount of lump sums taken as it will have been subject to a "special lump sum death benefit charge" and as the example shows, the pension income which was provided by this lump sum is used in calculating if there is any available Lifetime Allowance.

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