

Tech Talk

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Nominations

It has always been good estate and tax planning for clients and advisers to discuss what is to happen to any remaining pension fund following a client's death. This will take account of the client's personal and family circumstances, which may well change over time. The next step is to decide how best the client's wishes can be achieved. This discussion should not be a one off but revisited as circumstances change, to ensure that any arrangements regarding a client's unused pension fund on death, remain appropriate.

Following the Taxation of Pensions Act 2014, the subject of nominations has taken on even greater importance, as a way of ensuring that any remaining pension fund flows to the intended beneficiaries, following the member's death.

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Pension freedoms – widening of the class of individuals who can receive a drawdown pension

Currently, only a dependant of a deceased member can choose to take a pension. From 6 April 2015, a non-dependant can also choose to take a pension as they are no longer restricted to taking a lump sum. To facilitate this, the Taxation of Pensions Act 2014 introduces the concepts of nominee and successor beneficiaries. In other

words, dependants, nominees and successors are collectively grouped under the heading of “beneficiary”, and this effectively allows anyone falling within this group to take a pension, following the death of the member. The legislation regarding who can receive a lump sum death benefit remains unchanged.

Defining dependant, nominee and successor

From 6 April 2015, any remaining pension fund following a member’s death can be used to provide a dependant(s) or nominee(s) pension.

A dependant is defined by paragraph 15 of Schedule 28 of the Finance Act 2004. It includes:

- the member’s spouse or civil partner at the date of the member’s death or at the date the member first started to take benefits (if scheme rules allow)
- a child under age 23
- a child over age 23 but who in the opinion of the scheme administrator, was, at the date of the member’s death, dependent on the member due to physical or mental impairment
- any other person who, in the opinion of the scheme administrator, was, at the date of the member’s death, financially dependent on the member or financially interdependent with the member or dependent on the member due to physical or mental impairment.

Notably, “dependant” does not include adult children beyond the age of 23, or grandchildren, except if they meet the criteria noted above. Similarly, an unmarried partner is excluded from the definition.

These limitations are effectively removed through the ability of the member to nominate a “nominee”.

Nominee

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.

CASE STUDY

Paul has a SIPP. In the event of his death, Emma, his wife, would inherit sufficient non-pension assets so that she would have no need to access his pension fund. He is keen for his son Robert, who is in his forties, to benefit from his remaining pension fund by way of a drawdown pension.

This would not be possible under the current rules as Robert does not fall within the definition of a dependant.

Under the new rules, Paul could nominate Robert to be the beneficiary of his remaining pension fund. Robert chooses to take a drawdown pension.

The legislation also provides that any unused drawdown funds on the death of a dependant or nominee, can be passed on to a “successor”.

Successor

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.

CASE STUDY (CONTINUED)

Robert decides that any remaining pension funds on his death should pass to his daughters, and accordingly nominates them to benefit. Robert is the “nominee” and his daughters are the “successors”.

Paul, as the original member, can nominate a dependant and/or nominee to benefit from any remaining pension fund following his death. He is not able to nominate a successor in respect of the pension fund remaining on the death of a dependant or nominee. However, legislation does not require that funds remaining on the death of the dependant or nominee be used exclusively for a successor. Therefore, it would appear that there is scope within the legislation to allow the member to nominate another dependant and/or nominee to receive a pension death benefit and/or another person to receive a lump sum death benefit provided the scheme rules allow this.

So, Paul could nominate Robert to be the beneficiary of his remaining pension fund and could request that following Robert’s death, a dependant of his and/or nominee, could benefit from any remaining pension fund following Robert’s death.

In this case study, however, Paul simply nominated Robert leaving Robert able to nominate a successor to take over any remaining pension fund following his death.

How does a member nominate?

A nomination must be made in writing. To avoid any ambiguity, it's vital that the person nominating is clear about who is to benefit from any remaining pension fund following their death. If a scheme administrator is unable to identify and trace the nominated beneficiary they cannot take the nominator's wishes into consideration.

It is likely that pension providers will continue to offer an Expression of Wish form as the main way in which members and beneficiaries can indicate how they would like any remaining pension fund applied following their death.

An Expression of Wish can be changed at any time. This will generally be achieved through the completion of another Expression of Wish which will cancel and supersede the earlier one.

We mentioned earlier that it is important that the member reviews any arrangements, including any Expression of Wish, as circumstances change. This will be especially important where the intended beneficiary dies before the member or the member's relationship with the beneficiary changes.

It is important to note that the James Hay Partnership Expression of Wish is not binding on the trustee or scheme administrator of the scheme. Most Expression of Wish forms offered by SIPP providers will be drafted in this way. Whilst this means that a provider does not have to act on the Expression of Wish, and must consider other potential beneficiaries, they will usually follow the Expression of Wish.

The member or beneficiary can of course supply their own wording to James Hay Partnership, outlining how they would like any remaining pension fund dealt with, following their death, though it is strongly recommended that they seek appropriate tax and legal advice. In particular, the member should be aware of any IHT implications arising from the nomination.

IHT implications of nominations

The issue of whether a nomination is binding or not on the scheme administrator is important from an IHT perspective.

To quote from HMRC's Inheritance Tax Manual (IHTM17041) "Pension scheme benefits that are paid in accordance with a binding instruction by a person fall within that person's estate in accordance with IHTA 1984/S5(2). This applies primarily to death benefits paid to nominated beneficiaries where the scheme provider has no discretion over the payments".

So where a nomination is made, it is not so much whether the scheme administrator carries out the request(s) contained within, but rather that the scheme administrator should have discretion over the payment of death benefits to ensure that the value of the pension fund does not form part of the nominator's estate for inheritance tax purposes.

There is concern that the way the legislation is drafted will mean that the passing on of death benefits, as a flexi-access drawdown pension to a beneficiary, effectively removes any discretion by the scheme administrator, as to the recipients of a deceased individual's pension fund.

To recap, nominee of the member is defined as an individual nominated by the member, or nominated by the scheme administrator, who is not a dependant of the member. 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 nominated by the member.

The lack of discretion would seem to mean that the designation of funds for dependants'/nominees' flexi-access drawdown on the member's death, as well as any successors' flexi-access drawdown on the death of a dependant/nominee, would potentially be assessed to IHT.

That said, this would seem to run contrary to statements and publications from the Treasury and Chancellor. It is thought that the changes in legislation are not intended to change the IHT position with trustees still able to use their discretion. This point may only be settled if any challenge from HMRC is made.

To avoid this potential IHT issue, the individual could complete an Expression of Wish. Remember an Expression of Wish is not binding on the scheme administrator. Importantly, this means that the scheme administrator retains discretion over the payment of the death benefits.

What happens if there is no nomination?

Let's go back to our case study and assume Paul did not make a nomination. Remember that in the absence of a nomination made by the member, the scheme administrator can nominate anyone, unless there is a dependant of the member. In this case Emma is a dependant so that Robert cannot be a "nominee".

Under the James Hay Personal Pension Plan Scheme Rules, where there is no nomination by the member, we, as scheme administrator, may but need not apply the pension fund for the benefit of a dependant. If we apply the pension fund in favour of Emma, she can choose from a lump sum, drawdown pension or annuity. If we do not apply the pension fund for the benefit of Emma then the scheme rules allow us to pay a lump sum to a wide, defined class of beneficiaries which includes their son Robert.

This scenario demonstrates the importance of looking at the provisions within the Taxation of Pensions Act 2014, alongside a provider's scheme rules. Neither can be considered in isolation.

In the situation of a member having no dependants and they have not made a nomination and they did not set up a James Hay Partnership bypass trust, then we as scheme administrator have discretion to pay a lump sum to one or more persons amongst a wide class of potential beneficiaries. Furthermore, the statutory override within the Taxation of Pensions Act 2014 enables us to make certain payments including that of a drawdown pension to a nominee.

Where the member had no surviving dependants; had made a nomination but the nominated beneficiary predeceased the member, so that no valid nomination exists, then again we as scheme administrator have discretion to pay a lump sum. As in the previous section, we can also pay a drawdown pension to a nominee.

Where the member wishes a non-dependant to benefit from a drawdown pension they can complete an Expression of Wish.

Can a member nominate where there is a James Hay Partnership bypass trust?

Where there's an existing bypass trust, there will usually be no nomination by the member in place. This being the case, James Hay Partnership can exercise its discretion and apply the pension fund to a dependant following the member's death. If we do not exercise our discretion then a lump sum death benefit would be paid to the bypass trust.

As well as offering the bypass trust, we also provide a sample letter of wishes that can be used to accompany the bypass trust if appropriate. This letter of wishes is not a nomination but a non-binding letter from the member to James Hay Partnership. It notes the existence of a bypass trust, however, it asks that the scheme administrator, before paying any amounts to the trust, considers a request that all or part of the member's pension fund be paid to a named dependant. Following the dependant's death, any remaining pension fund is to be paid to the bypass trust.

Notwithstanding the existence of a bypass trust, it is possible for the member to nominate anyone to benefit from their pension fund following their death.

Where a provider's scheme rules might prevent anyone from benefiting from a member's pension fund, or where there is a restriction regarding the form that the pension fund can take, then there is a statutory override within the Taxation of Pensions Act 2014. This override enables trustees or managers of registered pension schemes to make certain payments including that of a drawdown pension to a dependant, nominee or successor.

Whilst the bypass trust is irrevocable once set up, and cannot simply be set aside for legislative changes, it is not the case that a lump sum death benefit will automatically be paid to its trustees following the member's death. The member is still able to nominate a "beneficiary" to take advantage of the pension freedoms effective from 6 April 2015.

James Hay Partnership is in the process of reviewing how the Taxation of Pensions Act 2014 sits in the context of its scheme rules and bypass trust. Any changes required to our scheme rules will be communicated as appropriate.

Conclusions

It has always been important for clients to be clear on what they would like to happen to their remaining pension fund on death.

It is likely that pension providers will continue to offer an Expression of Wish form as the main way in which members and others nominate to whom they would like any remaining pension fund applied on their death.

There is an Expression of Wish section within our SIPP application forms, as well as there being a stand-alone Expression of Wish form which can be found on the James Hay Partnership website. Along with other SIPP providers, we are currently reviewing our forms and literature to ensure that they facilitate the new pension freedoms effective April 2015.

Where bespoke nominations are drafted, it is recommended that appropriate advice is taken to ensure that they achieve what the individual intended following their death and that no adverse IHT implications arise.



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