

IHT & ASP - Budget Update

22/03/06

If any of you had the misfortune to sit and listen to the Budget then you will know that Mr Brown said nothing about pensions, although David Cameron did. DC pointed out that GB had said nothing about pensions, and commented on his £5million raid on funds (it was actually £5billion David ..) and the way that means testing is destroying private provision. However there were some snippets in the papers issued by the Revenue, particularly Budget Note 26 Inheritance Tax & Pensions Simplification.

The good news: The position **pre 75** will not change, so only those reducing withdrawals after being diagnosed will be caught.

The bad news : **Post 75** is worse than expected, although we will need to see the Finance Bill to get the details.

Here are some extracts from BN26:

Death of scheme member on or after age 75 – Alternatively Secured Pension

7. The Government provides generous tax relief on pensions on the basis that pension funds are used to secure an income in retirement. The pensions tax simplification rules provide that an individual must secure an income before they reach the age of 75. For most people an annuity or scheme pension is the best means by which they can do this. The new pensions tax regime introduces an additional option for securing their retirement income – an Alternatively Secured Pension (ASP).

8. The Government made clear throughout the development of the new pensions tax regime that ASPs are specifically designed for those who have a principled religious objection to annuitisation. It has become clear that some individuals and their advisors are intending instead to use the ASP provisions for a much wider purpose to enable individuals to pass on tax-privileged retirement savings to their dependants rather than to provide a pension in retirement. **In order to prevent this the Government is examining how best to restrict ASPs to their original limited purpose. (What I wonder does this mean? DT)**

9. Following a consultation by HMRC, legislation will be introduced in the Finance Bill to ensure that **appropriate IHT charges will apply on left-over ASP funds**. The Government will apply an IHT charge on left-over ASP funds on death (or later) as follows:

- **any funds paid as a “transfer lump sum death benefit”** (i.e. where the funds remain within the scheme for the benefit of other scheme members) or refunded to an employer or used to provide benefits for a dependant in the pension scheme context who is not a spouse, civil partner or person who is financially dependant **will be subject to an IHT**

charge on the death of the original scheme member as if the funds were part of the scheme member's own taxable estate on death;

- any funds paid on the death of the scheme member to charity will be exempt from IHT, as will funds expended for the scheme member's spouse, civil partner or person who is financially dependant on the scheme member;
- any left-over funds, once use by the spouse, civil partner or person who is financially dependant (the beneficiary) has come to an end, will be chargeable to IHT on the earlier of the cessation of those benefits and the death of the beneficiary. These remaining funds will be treated as if they were an addition to the original scheme member's estate. However, any left-over funds that are paid to charity will be exempt from IHT;
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The IHT charge

10. IHT will be payable on the value of the taxable property at the time the charge arises, and calculated by reference to the tax-free threshold and rate of tax in place at that time. The pension scheme administrator will be responsible for accounting for and paying any IHT due on the ASP funds.

12. HMRC will work closely with the pensions industry on the necessary processes to help minimise any regulatory impact on pension schemes. Personal representatives of estates will be required to provide information in the estate account about the ASP. This will include an estimate of the value of the left-over ASP funds at the date of death together with details of the name and address of the scheme administrator (who will be liable for any IHT payable).

I have now spoken to the Revenue about this. They confirmed as follows:

On death post 75 the whole remaining fund will be added to the estate for the purposes of calculating IHT. Because the tax free element is spread across the whole estate, the effective rate of tax will be a little below 40% as in the example below.

If someone has assets of £2,300,000 and a pension fund of £500,000 and they die in two years time aged over 75 with no spouse or financial dependant, then they can leave the £500,000 to charity and there will be no tax charge.

Alternatively they can leave the pension fund as a 'transfer lump sum death benefit' to e.g. a son's pension fund. The total value of the estate will be £2.8m, and the first £300,000 is exempt making the total tax $40\% \times £2.5m = £1m$. The administrator of the pension fund will have to deduct $500/2800 \times £1m = £178,571$ - an effective rate of 35.7% - from the amount transferred to the son's fund.

Just to clarify the tax actually charged is £200,000. £178,571 will come from the ASP fund, and the other £21,429 from the rest of the estate. Usually all IHT comes from the estate and not from individual assets, but in this case the ASP administrator must deduct it 'at source'.