



Taxation of lump sum death benefits

Who is likely to be affected?

- Beneficiaries of people who have died with pension savings in a registered pension scheme or non-UK pension scheme and
- scheme administrators of registered pension schemes

General description of the measure

A change is being made to the pensions tax rules to reduce the tax charge that applies to taxable lump sum death benefits paid from registered pension schemes or non-UK pension schemes.

Policy objective

This measure makes the tax system fairer by reducing the rate of tax payable on taxable lump sum death benefits from 45% to the recipient's marginal rate of income tax.

Background to the measure

The Taxation of Pensions Act received Royal Assent on 19 December 2014. From April 2015 lump sum death benefits paid from a registered pension scheme or non-UK pension scheme are taxed at 45% where the owner of the pension rights dies age 75 or over. If the deceased was under the age of 75, from April 2015 these lump sum death benefits are not taxed unless they are paid out more than two years after the scheme administrator became aware of the death. The two-year rule does not apply to the pension protection lump sum death benefit of the annuity protection lump sum death benefit.

The government has confirmed that from April 2016 taxable lump sum death benefits will be subject to tax at the recipient's marginal rate of income tax. Where the recipient is, for example, a trust or a company and so does not have a marginal rate the 45% charge will continue to apply.

Detailed proposal

Operative date

This measure will have effect in relation to lump sums paid on or after 6 April 2016.

Current law

Registered pension schemes are tax-advantaged vehicles intended to encourage saving for retirement. The legislation is mainly set out in Part 4 of Finance Act (FA) 2004 and supporting regulations.

Authorised payments of lump sums following the member's death are set out in section 168 FA 2004.

A registered pension scheme is only allowed to pay out benefits as authorised payments following the death of a scheme member in two forms, either as a pension or as a lump sum benefit. The type of benefits that can be paid depend on the exact circumstances and the

type of pension scheme and largely mirror the type of benefits that the member could have had from the scheme before death.

Lump sum death benefits are payable tax-free where anyone dies under the age of 75 provided the scheme administrator has determined who the recipient will be and designated the funds. If someone dies under the age of 75 and the required designation by the scheme administrator is not made within two years of the death, the lump sum death benefit is taxable at a flat rate of 45% before payment to the recipient. This two-year rule does not apply to the pension protection lump sum death benefit or the annuity protection lump sum death benefit. Lump sum death benefits are also taxable if the deceased was age 75 or over.

The scheme administrator of a registered pension scheme is liable for the tax charge on lump sum death benefits.

Where UK pensions tax relief has been provided to individuals who are members of non-UK pension schemes, there are similar tax charges to those that exist for registered schemes on payments following the individual's death. The recipient of the lump sum death benefit is liable for the tax charge where it is paid out of a non-UK pension scheme.

Proposed revisions

Legislation will be introduced in Summer Finance Bill 2015 to amend FA 2004 and ITEPA 2003.

Changes are being made so that where a lump sum death benefit is taxable it will be subject to the recipient's marginal rate of tax where the lump sum is paid directly from the pension scheme to an individual who is the ultimate beneficiary.

Taxable lump sum death benefits paid to an individual who is the ultimate beneficiary will no longer be subject to the special lump sum death benefits charge at 45%. They will be taxed as pension income and tax will be deducted under PAYE.

The tax charge will remain at 45% where the taxable lump sum death benefit is paid to someone other than an individual who is the ultimate beneficiary, such as a trust or a company.

Summary of impacts

Exchequer impact (£m)	2015-16	2016-17	2017-18	2018-19	2019-20
	-50	-155	-165	-175	-185
	This Exchequer impact forms part of the figures for 'Pensions flexibility: decisions since Budget 2014', which are set out in Table 2.1 of Autumn Statement 2014 and have been certified by the Office for Budget Responsibility. More details can be found in the policy costings document published alongside Autumn Statement 2014.				
Economic impact	This measure is not expected to have any significant macroeconomic impacts. A behavioural response to control for individuals increasing contributions into pensions to avoid Inheritance Tax is incorporated into the costing.				

Impact on individuals, households and families	<p>Around 320,000 people retire each year with defined contribution pension savings. These policy changes mean that if they die before taking all of their pension, their beneficiary will only pay income tax at their marginal rate rather than 45%.</p> <p>These changes are not expected to have an impact on family formation, stability or breakdown.</p>
Equalities impacts	<p>These measures will affect the recipients of lump sum death benefits where someone dies at age 75 or over. The recipients could belong to any age group. The government expects these measures to affect proportionately more women than men, as men are more likely to have pension savings and to die first.</p> <p>No other impacts are anticipated in respect of groups sharing other protected characteristics.</p>
Impact on business including civil society organisations	<p>This measure is expected to have a negligible impact on businesses and civil society organisations.</p> <p>There will be one-off burdens for pension scheme administrators including: training, familiarisation with the new rules and updating their systems.</p> <p>There will also be some increased ongoing burdens for pension schemes notably where they need to deduct tax at the recipient's marginal rate rather than at 45%. Also there will be some savings as most lump sum death benefits are payable tax-free where the holder of the pension rights dies under the age of 75.</p>
Operational impact (£m) (HMRC or other)	<p>There will be some changes to administrative processes to implement this change. HMRC is currently assessing the impacts of such changes.</p>
Other impacts	<p><u>Small and micro business assessment</u>: this measure is expected to have a negligible impact.</p> <p>Other impacts have been considered and none have been identified.</p>

Monitoring and evaluation

These measures will be kept under review through the monitoring of information collected on tax returns and tax records.

Further advice

If you have any questions about this change, please contact Beverley Davies on 03000 585266 (email: pensions.policy@hmrc.gsi.gov.uk).