

Pension death benefit Spousal bypass planning

The problem

The good news is that death benefit payments from occupational and personal pension schemes will usually be made free of inheritance tax (IHT). However, once the benefits have been paid out from the scheme to the beneficiaries – such as a surviving spouse – they will become taxable and subject to IHT as part of the beneficiaries' estates. If the beneficiary is the surviving spouse and he/she already has a potential IHT liability, his/her estate will be correspondingly increased and on death any unspent pension death benefit will be subject to IHT at the current rate of 40%. This has the potential to substantially increase the amount of IHT payable to HM Revenue & Customs (HMRC).

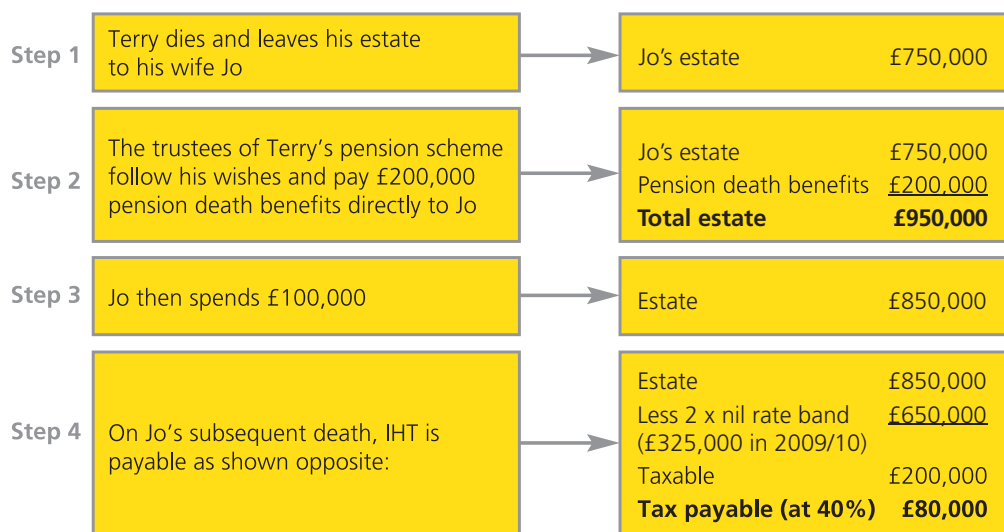
The solution

There are a number of possible solutions and one could be to consider spousal bypass planning using an appropriate trust. In simple terms, this type of IHT planning involves the creation of a lifetime trust by a pension scheme member in order that the trust receives the lump sum death benefits payable on his/her death before retirement. The key benefit of effecting such a trust is that as the surviving spouse is a potential beneficiary of the trust – and can benefit at the discretion of the trustees – the underlying trust fund remains outside his/her estate for IHT purposes.

Example

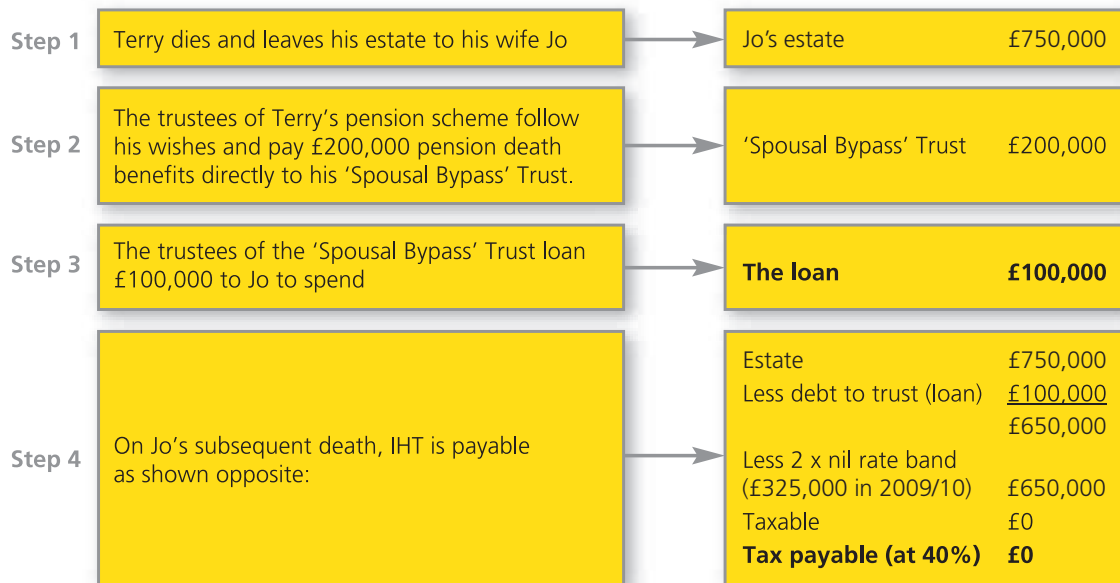
Terry is a scheme member. He dies and leaves his estate to his wife, Jo. The estate is valued at £750,000 (excluding pension death benefits). In line with Terry's wishes, the trustees of Terry's pension scheme pay his death in service benefits (DIS) of £200,000 to Jo, increasing the value of her estate to £950,000. Jo spends £100,000 of the pension death benefits before her own death. Terry's nil rate band transfers to Jo upon his death which means that Jo can benefit from two nil rate bands.

Position without Spousal Bypass Planning:



Position with Spousal Bypass Planning:

In this example Terry's pension scheme pay his DIS of £200,000 to his 'Spousal Bypass' Trust. The trustees choose to make a trustee investment with the DIS proceeds. Jo then takes a loan of £100,000 from the trust.

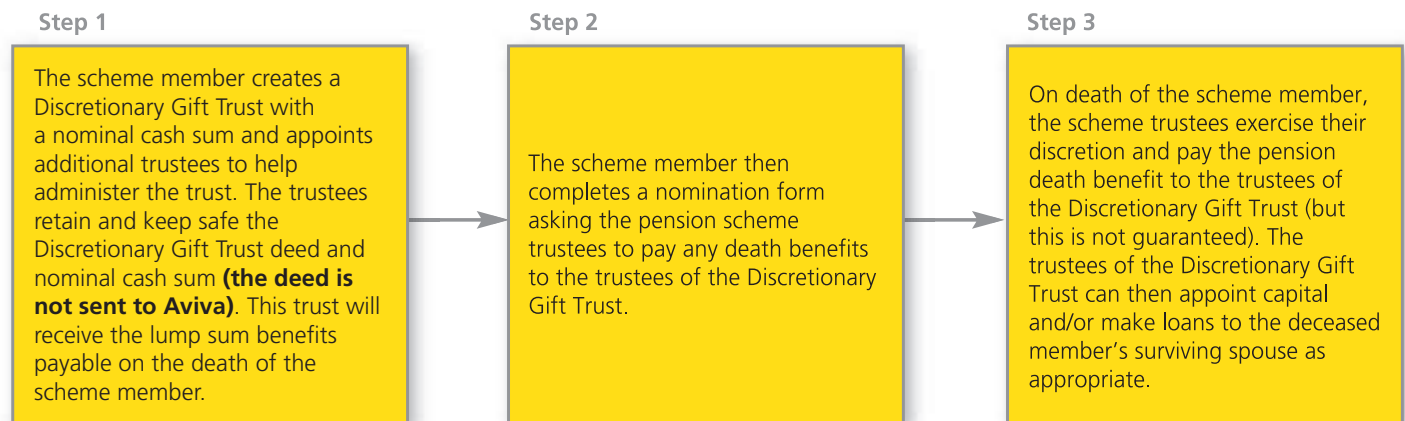


Summary

- Spousal Bypass Planning for Terry has saved £80,000 of IHT.

Spousal bypass planning using the Discretionary Gift Trust (Investment) from Aviva

How it works



Specialist IHT planning arrangements, such as spousal bypass planning, require careful consideration before taking any action. You and your clients are strongly advised to consider the tax, legal consequences and risks of such action. Your attention is specifically drawn to the taxation and legal structure of discretionary trusts, and further information can be found in our Adviser Guide, or from your professional tax and/or legal adviser.

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