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Clear View Financial Services Limited

Viewpoint

Pension death benefits
The pension freedoms brought with them significant changes to the taxation of pension death benefits.

Inflation: this time it's personal
Why is it that retirees and students face significantly higher levels of inflation than the official rate?

Investment jargon buster
A glossary of some of the common investment-related terms you'll come across.

Pension death benefits

Since the introduction of pension freedoms in 2015, we now have a range of options when deciding how to fund our retirement. But few of us stop to consider what might happen on our death: retirement itself seems far enough away!

Please contact me if you would like to discuss the pension death benefit rules and explore whether and how you and your loved ones could benefit from them.

The way that pension savings can be passed on in the event of the plan holder's death isn't always clear. However, alongside the more familiar changes to the retirement regime, the reforms heralded significant changes to how pension death benefits are taxed; bringing with them new inheritance planning opportunities.

Passing on your wealth

Since April 2015 it has been possible for the plan holder to pass their pension on to any nominee – or a number of nominees – through something called Nominee Flexi-Access Drawdown. Further, when the nominee dies, a successor – or successors – can also inherit a drawdown pension through a Successor Flexi-Access Drawdown. In turn, each nominee or successor can pass the assets on to other nominees or successors, retaining the tax efficiency of the plan through multiple generations.

The key benefit lies in retaining the assets within a pension wrapper: in this way they fall outside of the plan holder's assets for Inheritance Tax (IHT) purposes. And as long as they remain within the wrapper they retain their full tax advantages until they are needed by the nominee or successor.

If the plan holder – or a nominee or a successor – dies before the age of 75, not only are the assets passed on free of IHT, but the drawdowns are paid out free of income tax. If they die after the age of 75, the assets are still excluded from the estate for IHT purposes, but any lump sums or income drawdowns are treated as income and taxed at the marginal rate, ie. taking into account other sources of income.

How might your dependants benefit?

The example given below is a simplified illustration and only a guide to what might be achieved with careful financial planning.

However, it is important to note that most of the existing pension plans were set up before the new regulations came into force and may not have the flexibility to establish Nominee or Successor Flexi-Access Drawdown accounts. Instead, the pension provider will pay out the full value of the fund in cash on the death of the plan holder. In that situation, the assets count towards the total estate for IHT purposes and the tax benefits are lost.

HM Revenue and Customs practice and the law relating to taxation are complex and subject to individual circumstances and changes which cannot be foreseen.

The pension family tree

A family comprises a husband and wife, their two children who in turn have two children each (four grandchildren in total). The husband dies aged 76 with £500,000 remaining in his pension fund.

The wife inherits a Nominee Flexi-Access Drawdown plan. As her husband died after reaching the age of 75, any withdrawals are taxable as income. The wife dies aged 74 with £450,000 remaining in the plan.

The two children each inherit half of this (£225,000) through Successor Flexi-Access Drawdown. Withdrawals are tax free as the mother died before age 75. However, both children die in their 60s without accessing their plans. As they also died before reaching 75, each residual pension fund passes tax free to the grandchildren.

Each grandchild inherits a Successor Flexi-Access Drawdown pot of £112,500 and enjoys tax-free withdrawals.

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Inflation: this time it's personal

Much is made about the impact of inflation on the 'real' value of your income and investments. That is, the impact inflation has on your ability to continue affording your lifestyle.

For advice on savings and investments please talk to us.

The magic number

The Bank of England Monetary Policy Framework has an inflation target of 2%. The remit is not to achieve the lowest possible inflation rate as inflation below the target of 2% is judged to be just as bad as inflation above the target. However, this magic number masks a wide variation in the levels of inflation experienced by different groups of people as it is calculated using a basket of goods and services that's meant to reflect the spending habits of the 'average' household.

Research by the UK Office for National Statistics (ONS) highlights that those who are retired, or who have lower disposable incomes, face significantly higher levels of inflation than the rate used to calculate increases in the state pension and other benefits.

In fact, retirees and students experienced the highest rates of personalised inflation with the difference widening as the rate of inflation increases. For example, in 2003 the official inflation rate was 1.4%, while that of the lowest earners was 1.5%. In 2008 the official inflation rate was 3.6%, but 4.4% for the lowest earners.

The value of your investment and any income from it may fall as well as rise. You may not get back the amount you originally invested.

The effect of inflation on savings

Inflation is an economic fact of life but this analysis shows that in retirement you are likely to be faced with potentially higher levels of inflation than you're used to. Whilst the state pension currently features a 'triple-lock', this has not always been the case and may not hold in the future. And it only protects you from the 'average' level of inflation. Further, if you rely on your personal pension for 'the little luxuries' or even to maintain your basic expectations of a comfortable lifestyle, you will not be able to 'grow' this income through wage rises or by changing jobs as you may have been used to as an employee.

If the returns you get on your money are unable to at least match inflation, then your assets will effectively lose value each year. Depending on your personal circumstances, you may need an investment strategy with the potential to provide adequate real returns to address these inflationary issues. The road ahead is far from clear, but that's all the more reason to pay close attention to how your savings are invested.

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Investment jargon buster

Assets: *anything an individual, company or fund owns which has economic (tradable) value.*

Asset classes: *Groups of securities or investments with similar characteristics that behave in a similar fashion and are subject to the same laws and regulations. The most common ones are Cash, Shares, Property & Fixed Interest Securities.*

Bond: is an IOU for *a loan to a government or company. Usually for a fixed term and with a fixed rate of return paid to the investor at fixed intervals until the loan is repaid. Sometimes called Fixed Interest Securities.*

Commodities: *bulk goods traded on an exchange. Examples include gold, silver and platinum; iron, steel and tin; grain, coffee and sugar.*

Consumer Price Index (CPI): *periodically measures the price of a basket of goods and services purchased by households, used to give an indication of UK inflation.*

Default risk: *the risk that the bond issuer will not be able to repay the interest or initial investment to the investor.*

Developed market: *an established market economy, with sound, well-established economies and are therefore thought to offer safer, more stable investment opportunities than developing markets.*

Diversification: *a policy of reducing your exposure to any one particular asset or risk. This usually involves selecting a range of asset classes which do not move in perfect synchronisation with each other.*

Dividend: *a distribution of profits to shareholders. Each share is allocated a percentage of the distribution.*

Emerging markets: *less developed economies generally characterised as transitioning from a restricted or controlled economy to a free-market economy, with increasing economic freedom, and gradual integration into the global economy.*

Equity: *a share in the ownership of a company.*

Fiscal policy: *government policies that seek to influence the domestic economy including tax rates, interest rates and spending policies.*

Fixed Income Security: *a loan to a government or company, usually for a fixed term and with a fixed rate of return paid to the investor at fixed intervals until the loan is repaid.*

Investment trust: *Set up as companies with a fixed number of shares and like any listed company the shares trade. Allows you to pool your money with other investors to get access to range of assets through a single investment.*

Mutual fund: *allows you to pool money with other investors to purchase stocks, bonds and other securities.*

OEIC (Open Ended Investment Company): *this is a collective investment fund. Managers pool investors' money to buy shares, bonds cash, property and other investments. The number of shares in circulation varies depending on demand from investors.*

Retail Price Index (RPI): *Like the CPI, this tracks changes in the cost of a fixed basket of goods over time. However, the RPI also includes housing costs, such as mortgage interest payments and council tax, as well as TV licence and road tax costs.*

Risk: *the chance that an investment will lose value or that its return will be less than expected.*

Structured deposit*: a portfolio that offers a degree of protection to capital whilst offering the potential for higher returns. The higher the risk to capital, the greater the potential return.*

Volatility: *a risk measure that describes the degree to which performance varies over time and thus an indication of one's ability to predict whether performance is going to be positive or negative.*

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