Case Study - Exploring Pension Options

One of the most important decisions a client will make is how to access their pension.

This document is based on London & Colonial Assurance PCC Plc's understanding of applicable UK tax legislation and current HM Revenue & Customs practice, as of March 2024, which could be subject to change in the future.

Joe:
- aged 66
- lives in England
- with his partner Susan

Joe decides to take his defined contribution pension fund taking the maximum pension commencement lump sum. Below we compare Joe accessing his pension via pension drawdown verses purchasing London & Colonial Assurance PCC Plc's ('LCA') Flexible Pension Annuity.

Pension Drawdown

During Joe's lifetime the income received is treated as pension income and taxed accordingly. But what happens on Joe's death? Let's look at two examples where Susan decides to take the death benefit as a lump sum.

Example 1 — Joe dies aged 72

Any lump sum payable to Susan needs to be tested against the lump sum and death benefit allowance (£1,073,100), with any excess being subject to UK income tax at Susan's marginal rate.

Remember that if the lump sum is not paid within two years of Joe's death (or the date the scheme administrator knew of his death) those benefits will also be taxable.

Example 2 — Joe dies aged 80

As Joe died after age 75 the death benefit paid to Susan will be taxed, as income, at her marginal rate of UK income tax.

On Joe's death there is a death benefit of £100,000. Currently Susan's taxable income is £40,000 so her taxation is:

- Personal Allowance £12,570 @ 0%
- Remaining £27,430 @ 20% = £5,486
- Marginal rate of tax is therefore 13.72% (£5,486/£40,000)

If Susan decides to take the entire £100,000 death benefit in a single payment her taxable income would be £140,000. This would affect her personal allowance (for every £2 over £100,000 the personal allowance is reduced by £1). This means that for this tax year she will have no personal allowance resulting in more of her other income being taxed at a higher rate.

If Susan takes the entire fund as a lump sum her taxation would be:

- £37,700 @20% = £7,540
- 87,440 @ 40% = £34,976
- £14,860 @ 45% = £6,687
- Total tax = £49,203 meaning her marginal rate is now 35.15% (£49,203/£140,000)

An alternative would be for Susan to take the benefits as an income, for example setting the income at £10,270 would mean that her income stays under the higher tax rate band of £50,270.

Flexible Pension Annuity

Most lifetime annuities provide an income based on a guaranteed annual growth rate and whilst they provide a guaranteed income, they are less flexible than a drawdown.

The Flexible Pension Annuity ('FPA') is a unit-linked lifetime annuity which means, just like drawdown, Joe can ensure that the investments chosen meet his attitude to risk. However, being a Gibraltar based company, LCA can offer full open architecture meaning that Joe can choose from a wider range of permitted investments.

During his lifetime, the annuity payments are treated as pension income and taxable at Joe's marginal rate of UK income tax. The FPA is very flexible and allows Joe to vary the amount and frequency of the annuity payments. But what happens on Joe's death?

On Joe's death the FPA ceases, and no further benefits are payable from the contract. But when Joe purchased his FPA he also had the option to purchase a preference share in London & Colonial Assurance PCC Plc, a protected cell company. The purchase of the preference share is totally separate to the purchase of the FPA but if Joe decides to purchase the preference share the share will be linked to the cell which holds all the assets that back his FPA.

Whether Joe dies aged 72 or 80 the ownership of his preference share passes to his personal representatives. As a personal representative they must value all of Joe's estate which includes the value of the preference share (the value of the remaining investments held within the cell) for inheritance tax ('IHT') purposes.

Under IHT legislation there are reliefs and exemptions that allow assets to be passed on to a deceased's beneficiaries tax-free. One such relief is Business Relief. Where the asset is a share in an unlisted trading company, 100% business relief is available, provided the asset was owned by the deceased person for at least two years before they died and continued to be held on death.

London & Colonial Assurance PCC Plc is an unlisted trading company so the preference share can potentially benefit from 100% business relief.

Therefore, irrespective of whether Joe dies aged 72 or 80 Susan, as beneficiary of his estate, could receive the remaining value of the assets held in the cell without being subject to income tax or IHT.

Susan can then choose how to invest or spend her inheritance.

The Flexible Pension Annuity offers:

- Flexibility to vary the amount and frequency of the annuity payments.
- Gross roll-up, which means that any income or growth made on the underlying investment is not subject to tax at source – apart from an element of withholding tax.
- The ability to consolidate multiple pension plans.
- A death benefit free of inheritance tax irrespective of when death occurs (provided a preference share has been bought and on death the share has been held for at least two years).

Case Study - Exploring Pension Options

Summary

Taxation	Pension Drawdown	Flexible Pension Annuity (FPA)
Income during lifetime	Taxed as pension income	Taxed as pension income
Taxation of Death Benefits before age 75	Only tax-free up to the available lump sum and death benefit allowance*	Tax-free if a preference share has been bought and on death the share has been held for at least two years.
Taxation of Death Benefits after 75	Taxed as income in the hands of the beneficiary at their marginal rate of income tax	Tax-free if a preference share has been bought and on death the share has been held for at least two years.
Inheritance tax	Tax-free provided Scheme is established under discretionary trust*	Tax-free after two years of owning a preference share

*Please note that on death if the death benefit was paid out more than two years after death (or the date the scheme administrator became aware of his death) income tax would be payable.

Want to know more?

If you would like further details on our Flexible Pension Annuity or any other product we offer, please contact your dedicated business development manager or email sales@stmgroup.online.

LONDON & COLONIAL
INNOVATION IN PENSIONS

options for your tomorrow™

Postal Address:
London & Colonial Assurance PCC Plc
3rd Floor
55 Line Wall Road
Gibraltar, GX11 1AA

T (UK): 0044 (0)2036 406843
T (Gibraltar): 00350 200 75812

www.londoncolonial.com
LCA@stmgroup.online