

Pension death benefits

At a glance

Quilter

What is the tax status for different pension death benefits?

Whether a death benefit is taxable depends on the deceased member's/deceased beneficiary's age when they die, what type of benefit is being taken and how long it takes to finalise that benefit.

Death under age 75, benefit finalised within 2 years

| Benefit type | Taxable |
|---|---------|
| Lump sum paid from uncrystallised funds, within ILSDBA* | NO |
| Lump sum paid from uncrystallised funds, above ILSDBA* | YES |
| Lump sum paid from funds crystallised before 6/4/24 | NO |
| Lump sum paid from funds crystallised after 5/4/24 within ILSDBA* | NO |
| Lump sum paid from funds crystallised after 5/4/24 above ILSDBA* | YES |
| Flexi-access drawdown or annuity | NO |

*Individual's lump sum and death benefit allowance

Death under age 75, benefit finalised after 2 years

| Benefit type | Taxable |
|----------------------------------|---------|
| Lump sum** | YES |
| Flexi-access drawdown or annuity | NO |

** This excludes pension/annuity protection lump sum death benefits and charity lump sum death benefits as they do not have a 2 year rule

Death after age 75

| Benefit type | Taxable |
|----------------------------------|---------|
| Lump sum*** | YES |
| Flexi-access drawdown or annuity | YES |

***A charity lump sum death benefit is always tax-free.

What tax is due?

Individuals

- Taxable benefits, are taxed at the individual's marginal rate, no matter the reason for being taxable.
- If the pension scheme is deducting tax, where they do not hold a tax code (which will be the case for lump sums), emergency tax will be deducted. So the beneficiary may need to pay further tax or make a claim for overpaid tax.
- Lump sum payments to a bare trust are taxed as if paid to the trust beneficiary directly.

Non-Individual

- Where benefits are taxable because they exceed ILSDBA, the tax due is marginal rate. For a discretionary trust this is 45% *. For other non-individuals eg a company or a legal representative, marginal rate is the basic rate of tax for those entities.
- Where benefits are taxable because the member dies over age 75, the tax charge is the special lump sum death benefit charge which is 45%**.
- Where benefits are taxable because the lump sum is not paid within two years of notification of death, the tax charge is the special lump sum death benefit charge which is 45%**.

* A tax-free band of up to £500 applies where the trust's total income is below £500 in a tax year. <https://www.gov.uk/trusts-taxes/trusts-and-income-tax>

** If a lump sum is paid to a discretionary trust, then paid to a beneficiary who is a UK individual, that beneficiary will be given a tax credit for the 45% tax charge. They may be able to reclaim some or all of this from HMRC.

Additional useful information

Lump sums, flexi-access drawdown and annuities are what is available under legislation, however a scheme may offer less. You should check with the scheme what is available under the scheme rules. Quilter offers all 3 options.

There is no minimum or maximum age for taking death benefits. So for example a child can take income from beneficiary drawdown both before and after age 23.

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